

BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF WASHINGTON

In the Matter of the)
Application regarding the)
Conversion and Acquisition)
of Control of Premera Blue) Docket No. G02-45
Cross and its Affiliates)
)
)
)

Adjudicative Hearing
May 13, 2004
Day 8
(Pages 1708 to 1945)
Tumwater, Washington

Taken Before:

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P R O C E E D I N G

2

3

JUDGE FINKLE: Ready to proceed?

4

MR. KELLY: Yes, we are.

5

JUDGE FINKLE: Good morning. Please sit down.

6

MR. KELLY: Okay.

7

8

CROSS-EXAMINATION

9

(Resumed)

10

11

BY MR. KELLY:

12

Q Good morning, Ms. Hunt. I'm going to try to do this in 15 minutes, you and I, I hope.

13

14

A Great.

15

Q First area of questioning: You were talking in your - when you were giving your experience yesterday about your various activities, but there has been only one conversion in which you have been previously involved in and that was Kansas; is that correct?

16

17

18

19

20

A Yes.

21

Q Now, you were deposed on November 25th last year, which was after the PwC Economic Impact Analysis report had been completed and filed.

22

23

24

And my question to you is as of the date of the

25

deposition, you were not aware of any literature that

1 supported the observation and belief that not-for-profits
2 behaved differently than for-profits, were you?

3 A I'm not sure if that was the exact quote. I believe that at
4 that time I had reviewed literature, but I could not call to
5 mind the titles.

6 MR. KELLY: I guess we ought to open up the
7 deposition.

8 THE WITNESS: Okay.

9 MR. KELLY: This is just the November 25th dep.
10 There is also exhibits, which I don't think we are going to
11 go into. They are not pertinent to this question. It will
12 save some ripping.

13 MR. HAMJE: Mr. Kelly, did you say November 25th?

14 MR. KELLY: Right. It would be Volume 2

15 MR. HAMJE: Thank you, sir.

16 MR. KELLY: Volume 1 and then Volume 2 is there.

17 Do you have a copy?

18 THE WITNESS: Yeah.

19 MR. KELLY: Would you like a copy as well?

20 MS. SUREAU: If you have one.

21 MR. KELLY: I think I have an extra one.

22 MS. SUREAU: Thanks, Mr. Kelly.

23 MR. KELLY: Sure.

24 Q (BY MR. KELLY) Okay. If you would turn your attention to
25 Page 296, which I think is in Volume 2.

1 A (Complying.)

2 Q And Page 296, did you not - did I not ask you this question
3 and did you not give the following answer?

4 Question: "And you were not aware of any literature
5 that supports this observation and belief that
6 not-for-profits behave differently than for-profits?"

7 Answer: "No."

8 Is that your answer?

9 A At that line, yes.

10 Q Right. And there is nothing in your report that you had
11 filed as of that date that references any such literature,
12 is there?

13 A I don't believe we included the bibliography, no.

14 Q Now, then I go on to say - I ask the question the other way:

15 "Do you see anything supports the proposition?" And
16 that's when you say you don't know anything off the top of
17 your head and so forth; is that correct?

18 A That is what it says here, yes.

19 Q And since that time you have heard of the Schneider,
20 Zaslavsky and Epstein study in the New England Journal of
21 Medicine, have you not?

22 A I'm not recalling exactly what article that is.

23 Q Were you - did you happen to be here when Sally Jewell
24 testified?

25 A I was not, no.

1 Q Were you here when Dr. Gollhofer testified?

2 A Yes.

3 Q Okay. Do you remember him talking kind of extensively about
4 that article and the activities of for-profit and
5 not-for-profit insurance carriers?

6 A I did, yes.

7 Q Okay. Did you then, after hearing about that, read that
8 literature?

9 A I had read that before, yes.

10 Q Okay. Okay. That's all I have on that.

11 Let me ask you to go to your responsive testimony, which
12 is Exhibit S-48.

13 A (Complying.)

14 Q Okay. And if you would turn to Paragraph 4, which is on
15 Page 3 - and, actually, what I'm going to focus on is the
16 chart that is on - on Page 4, which I think you testified a
17 little bit about yesterday; is that correct?

18 A Yes.

19 MR. KELLY: Is this another one of those - is this
20 one where the --

21 MS. BEUSCH: The Judge has it.

22 MS. SUREAU: It's all right.

23 JUDGE FINKLE: We have it, in a different form.

24 MR. KELLY: You know, actually, I have extra copies
25 of this. Actually, I made extra copies of an excerpt of

1 this - of this stuff.

2 MS. SUREAU: You know, Mr. Kelly, we can use the
3 original.

4 Oh, thanks. That's easier.

5 MR. KELLY: Okay.

6 Q (BY MR. KELLY) So, in any event, in this Paragraph 4, your
7 are criticizing Dr. McCarthy; is that correct?

8 A We are responding to Dr. McCarthy.

9 Q Okay. And, of course, what you are doing is, as I
10 understand it - is providing what you think is additional
11 descriptive data that you wanted to add into the record; is
12 that true?

13 A Yes.

14 Q Okay. Now, what Dr. McCarthy is arguing is that if Premera
15 tried to raise prices, competition would respond by
16 offering - by coming into the market and offering - and/or
17 offering products at lower prices; is that your
18 understanding?

19 A I believe that that is correct.

20 Q Okay. And this is just a historical review of events that
21 you are talking about, it does not say that at any
22 particular time Premera raised prices and then there was
23 some sort of response or not some sort of response; isn't
24 that true?

25 A Yes.

1 Q Okay. Now, let's talk a little bit about this chart.

2 First of all, I noticed that at the top of it you say it
3 was adapted from Table 3 of the NERA report; isn't that
4 true?

5 A Yes.

6 Q Okay. And if you would take a look - I hate to do this to
7 everyone - at Exhibit P-22, which is the NERA report. Do
8 you have a copy of that --

9 A No, I don't.

10 Q -- Ms. Hunt?

11 We'll get you one.

12 MR. KELLY: I will put this down here.

13 THE WITNESS: If we are finished with it.

14 Q (BY MR. KELLY) Okay. And if you would turn on P-22 to Page
15 17 --

16 A (Complying.)

17 Q -- you will see Table 3 there. Do you see it?

18 A Yes.

19 Q Now, that only has 14 entries; isn't that correct?

20 A Yes.

21 Q Okay. And what you did with your chart is add in three new
22 entries; isn't that true?

23 A It has been a while since I looked at this, but, yes, we did
24 include some that are more recent.

25 Q Right. And, actually, you also deleted some, didn't you?

1 A We were focusing on Eastern Washington, so we did not
2 include the Western Washington items.

3 Q Okay. Now, Dr. McCarthy never claimed that the three items
4 that you added were something that he was basing his
5 testimony upon, did he?

6 A No.

7 Q Okay. Now, isn't it really a strawman argument to add in
8 three new things that the other guy didn't rely upon?

9 MS. HAMBURGER: Objection. Argumentative.

10 JUDGE FINKLE: Sustained.

11 Q (BY MR. KELLY) In adding in the three new items that
12 Dr. McCarthy didn't rely upon, what - you were not
13 demonstrating any defect in Dr. McCarthy's database, were
14 you?

15 A We were attempting to show the plans that had entered and
16 exited the market.

17 Q Okay. Well, let's take a look at that for a minute. Let's
18 look at the first one on your chart, which is King County
19 Medical now doing business under Regence.

20 Now, King County Medical or Regence did go over to Walla
21 Walla, did it not?

22 A Yes.

23 Q Okay. And it is still there, is it not?

24 A Yes.

25 Q And, as a matter of fact, Regence has been quite successful

1 over in Walla Walla, has it not?

2 A Yes, it has.

3 Q And do you know what percentage of the market share for
4 Walla Walla County Regence has at this time?

5 A I don't, but it is material.

6 Q Okay. Would you agree with Dr. - Dr. Leffler in his report
7 in his Table 1-A that Regence has 68.1 percent of the market
8 share in Walla Walla County?

9 A I have no reason to dispute that.

10 Q And would you agree with Dr. Leffler that Premera, for
11 example, only has 30.9 percent of the share in Walla Walla
12 County?

13 A I believe that that's correct. I don't recall the numbers.

14 Q Okay. And let's take a look at Number 6. I think it is
15 your sixth one down on your chart. It is entitled, "1998
16 NYLcare." Do you see that?

17 A Yes.

18 Q Now, NYLcare in 1998 decided to go from Western Washington
19 to Eastern Washington, did it not?

20 A Yes.

21 Q Okay. And at about that time Aetna bought NYLcare; isn't
22 that true?

23 A Yes, just - it is typically called NYLcare (pronouncing).

24 Q NYLcare, you are right. Sorry.

25 Now, since moving over to Eastern Washington, NYLcare,

1 now known as Aetna, has developed a number of subscribers,
2 has it not?

3 A A fairly small number by our count.

4 Q Right. In your count, it was less than 300; is that
5 correct?

6 A Mm-hmm.

7 Q Okay. Could you take a look at Exhibit P-32, please?

8 A I don't have that.

9 Q Okay. We will be getting that for you in a minute.

10 A Are you done with this one?

11 Q Yes.

12 Now, P-32 is a report from HealthLeaders Research, is it
13 not?

14 A Yes.

15 Q Okay. Yesterday you told us that's the type of data you
16 rely upon; correct?

17 A That we look at. I didn't say that we relied upon it.

18 Q Okay. So if you would take a look at Page 3-3 of that
19 exhibit?

20 A (Complying.)

21 Q And I'm going to ask you to look at the first line, under
22 "PPO Serving as Single Insurer," there is Aetna. Do you see
23 that?

24 A Yes.

25 Q Now, I know this is hard to read, but it's the best we could

1 do here. If you go over to the column, "Richland,
2 Kennewick, Pasco," they have 2,708 lives; correct?

3 A That's what it says, yes.

4 Q And in Spokane instead of the 300 lives that you found, this
5 HealthLeaders Research reports 3,908 lives; is that correct?

6 A That's what it says, yes.

7 Q Okay. And I'm reading these specific columns because they
8 are in Eastern Washington. And in Yakima, 962 lives; is
9 that correct?

10 A That is what it says, yes.

11 Q And then if you go down to the - I guess, it is about five
12 lines up from the bottom, do you see where it says, "PPO,
13 POS Enrollment" and "Aetna" right below it?

14 A Yes.

15 Q And if you go over to "Richland, Kennewick, Pasco," it is
16 3,280 lives. Do you see that?

17 A Yes.

18 Q And if you go over to Spokane, 2,539 lives; correct?

19 A Yes.

20 Q And if you go to the Yakima column, 218 lives; is that
21 correct?

22 A That is - that is what it says.

23 Q Will you trust my math that that all adds up to 13,615 lives
24 in Eastern Washington for Aetna?

25 A I will trust your math.

1 Q Okay. The next topic I wanted to go on to was your
2 statements about Premera's ASC business.

3 A Excuse me. Can we - are we done with all this?

4 Q Wherever - yes. And if you want to put that on the side,
5 that may help.

6 I think you said something in your testimony yesterday
7 about Premera setting the price for its ASC business. Do I
8 have that right?

9 A Can you be more specific?

10 Q I'm only going from my memory what your testimony was.
11 Didn't you say that Premera is in some ways setting the
12 price for its ASC business and I guess implying that we were
13 setting it too low?

14 A I believe my testimony was that in establishing the price
15 for the ASC business that Premera chose to price it at a
16 level that covers marginal plus a portion of fixed cost.

17 Q Okay. Well, that to me says that Premera is setting the
18 price, or fixing the price, whatever term you want. They
19 are choosing the price?

20 A I think Premera chooses the price for all of its products.

21 Q Okay. Now, are you aware that Dr. Leffler says that ASC is
22 among the most competitive products that Premera deals with?

23 A I don't recall that specific statement, but it wouldn't
24 surprise me.

25 Q Okay. And that's because it involves large groups and large

1 groups have lots of choices; is that correct?

2 A That would be one of the reasons, yes.

3 Q And when the - you are in a very competitive situation,
4 competition sets the price, not the wishes and druthers of
5 those who would like to sell something; isn't that true?

6 A That would be one interpretation.

7 Q All right. So all that Premera can do, along with all the
8 other competitors in the ASC area, is determine the bid that
9 they are going to offer and hope that the - that the company
10 will accept it; isn't that true?

11 A Well, there comes a point at which the price that you can
12 sell at doesn't cover your costs, so it is not profitable to
13 sell it.

14 Q Did you hear the testimony of Kent Marquardt earlier in this
15 hearing about ASC and what the plans are by Premera as to
16 how to improve their profitability area in regard to ASC?

17 A I heard most of his testimony. I don't recall that
18 particular issue.

19 Q Do you recall - did you hear Mr. Koplovitz's testimony?

20 A I did.

21 Q And do you remember him saying in response to
22 Ms. McCullough's questions about whether Premera was losing
23 money on the Microsoft account as opposed to the ASC
24 account, on a fully-allocated cost basis you might look at
25 it that way, but didn't he say it is making a contribution

1 to the bottom line?

2 A I will believe you if he said those exact words. That is -
3 that is certainly the nature of his testimony.

4 Q And you agree with that testimony, don't you?

5 A I'm not sure if I specifically agree with that testimony.

6 Q Well, now is your chance. Do you agree with Mr. Koplovitz
7 on that point or do you disagree?

8 MS. HAMBURGER: Objection. It is argumentative.
9 She answered that question.

10 MR. KELLY: I don't think she answered it.

11 JUDGE FINKLE: Try rephrasing.

12 Q (BY MR. KELLY) Do you degree with Mr. Koplovitz that the
13 Microsoft business is making a contribution to the bottom
14 line for Premera?

15 A I don't know if Microsoft itself is, but I do believe that
16 the ASC business itself is.

17 Q Okay. And he also said words to this effect that if that
18 business went away, Premera would have to spread its fixed
19 costs over other customers. Do you agree with that
20 statement?

21 A Yes, I do.

22 Q Okay. Now, I want to turn briefly to rates. As I
23 understand it, you and your team are claiming that Premera
24 would raise rates or could raise rates in the individual and
25 small group in Eastern Washington?

1 A Yes.

2 Q Okay.

3 MR. KELLY: And I'm sorry to do this, but if I don't
4 - interrupt the question myself -- but I would like to offer
5 P-32, the HealthLeaders report that hasn't already been
6 offered that we referred to earlier for . . .

7 MR. HAMJE: We object. There has been no
8 authentication to this particular report. We don't know
9 where it comes from, who it is relying upon and what it
10 involves.

11 This was previously offered by Mr. Mitchell, I believe
12 it was either yesterday or the day before, in which we -
13 which we - at that time, Mr. Mitchell agreed to rest subject
14 to we offered - reoffering the exhibit at another time, but
15 - I just want to point that out.

16 But we are objecting because we don't believe it has
17 been authenticated and we don't know how it ties into -
18 whether the information contained in it has any
19 authoritative value.

20 MR. KELLY: Well, I --

21 MS. HAMBURGER: Additionally, I would just like to
22 object because this witness specifically said she did not
23 rely upon the data in drawing her conclusions.

24 MR. KELLY: Well, my argument is that she said this
25 is type the data that she utilizes. I think certainly for

1 the low, low levels of evidentiary admission, this makes it.

2 And, number two, if counsel is really going to seriously
3 claim that this is not an authentic document, if have to go
4 out and prove it, I ask that we have the same rules in
5 court, namely whatever it costs us to prove it, Mr. Hamje
6 will have to pay that cost. This is on its face clearly an
7 appropriate document.

8 JUDGE FINKLE: Let's separate the two objections.
9 Are you suggesting that this may not be authentic, that is
10 what it purports to be?

11 MR. HAMJE: No, and I'm sorry, that's not really
12 what I meant. I wanted to make sure that clearly it is not
13 authoritative, that the information contained in it has any
14 meaningful value.

15 JUDGE FINKLE: Admitted. I believe there is enough
16 foundation and it goes to the weight.

17 Q (BY MR. KELLY) Okay. Now, to get back to my questioning, I
18 honestly can't remember your answer. Is it your team's
19 claim that Premera could raise rates in individual and small
20 group products in Eastern Washington?

21 A Yes.

22 Q Okay. Now, that, of course, assumes that Premera has market
23 power if they were to try to do that; is that correct?

24 A It presumes that it has the ability to influence the market,
25 yes.

1 Q And you also state that the rates in Western Washington
2 would remain the same if Premera was to try to do this in
3 Eastern Washington?

4 A Yes.

5 Q And then you say as a result of using this geographic factor
6 so as to increase rates in Eastern Washington and keep them
7 the same in Western Washington, that the total average rate
8 would go up; isn't that true?

9 A Yes.

10 Q Okay. And Premera's overall margin would go up under your
11 theory; isn't that correct?

12 A Yes.

13 Q But those results, increased total average rate and
14 increased margin, aren't allowed under Washington insurance
15 laws and regulations, are they?

16 A When Marty Staehlin testifies later he will explain how
17 those calculations would work.

18 Q Okay. So you can't testify to that? We are just going to
19 have to rely on Mr. Staehlin to explain it?

20 A Yes.

21 Q Okay. Now, I would like to turn to the model and see if you
22 can tell us anything about this, about the model.

23 Now, the model does not make a prediction that rates
24 will go up, does it?

25 A No, it makes a calculation.

1 Q Okay. That's good.

2 So the model - for example, this would be similar to a
3 model where if I were a consultant making \$100,000 a year
4 with a \$50 an hour rate and my goal was to increase my
5 income from \$100,000 to \$300,000, using a model like this, I
6 could say how much do I have to increase my rate in order to
7 achieve my target objective of \$300,000 a year; is that
8 correct?

9 A That would be one part of the calculation.

10 Q Okay. So the model that you have created is driven by the
11 proposed result, i.e., achieving the target margin; isn't
12 that true?

13 A This is an area that Ed Gold will testify about, but there
14 are multiple components including an elasticity judgment
15 that takes into account the probability of drop off in
16 enrollment.

17 Q That's not responsive to my question, which is very simple:
18 The model is driven by the proposed result; isn't that true?

19 A Yes.

20 Q And the model is not predictive of that result, is it?

21 A No. It takes qualitative assessment in combination with
22 quantitative calculation.

23 Q Good. Almost through here.

24 You talked about a three-year period for assurances. My
25 question to you is there is no industry standard calling for

1 a three-year period, is there?

2 A No.

3 Q And, finally, on the bring-down certificate issue, is there
4 any recognized standard in the industry as to what
5 percentage change in enrollment in a given line of business
6 constitutes a material change in that business?

7 A No, there is not.

8 Q And I think there is a three percent overall proposal that
9 you have. And do you recall my asking you whether that was
10 any sort of accounting requirement?

11 A I recall the question.

12 Q And you recall your answer was no?

13 A I believe that's correct.

14 Q Okay.

15 MR. KELLY: Excuse me for a minute.

16 That's all I have. Thank you.

17

18 CROSS-EXAMINATION

19

20 BY MS. HAMBURGER:

21 Q Good morning. You - in your report you recommended - the -
22 PwC recommended that these economic assurances be in place
23 for three years or longer; is that correct.

24 A Yes.

25 Q And those assurances might mitigate the problem, but they

1 don't eliminate the problems they are meant to address?

2 A That's correct.

3 Q They simply postpone when the problems might occur; is that
4 right?

5 A That is a possibility, yes.

6 Q And so it is possible at the end of the time limits that
7 those problems may still exist?

8 A Yes.

9 Q Okay.

10 MS. HAMBURGER: Thank you.

11 MR. HAMJE: Oh.

12

13 REDIRECT EXAMINATION

14

15 BY MR. HAMJE:

16 Q Ms. Hunt, if you could refer back to your prefiled
17 responsive, I believe it is Exhibit S-48. And, again,
18 Page 4 of the chart that you and Mr. Kelly were discussing.
19 Upon what information did you base that entry in the NYLcare
20 line, about 300?

21 A Those are from the Form B filings that we obtained from the
22 OIC.

23 Q Are you - do you have any familiarity with the report and -
24 and the information contained in the report that was
25 admitted as P-32 that you refer - that you were asked to

1 refer to?

2 A I am not familiar with that data, no. I don't know if it
3 contains a combination of self-insured plus
4 commercially-insured or - I'm just not sure exactly what is
5 in that report.

6 Q Do you know what year it claims that the information
7 pertains to?

8 A I believe - I believe it cited 2003, but I'm not sure.

9 Q And what year was the information that you relied upon?

10 A That would be 2002.

11 Q Would you please explain to the Commissioner what a master's
12 degree in public policy analysis entails?

13 A Sure. That particular degree requires a number of courses
14 in statistics, economics, policy and analysis techniques,
15 organizational theory, a lot of business administration type
16 classes, finance, very quantitative focused.

17 Q Yesterday Mr. Kelly asked you about your consulting with
18 Mr. Gold during the preparation of these reports. Do you
19 recall that testimony?

20 A Yes.

21 Q Would you please describe the team dynamics among the four
22 members involved in putting together the - the economic
23 impact reports?

24 A Yes. The - the Economic Impact Analysis was performed
25 primarily by four individuals: Myself, Marty Staehlin, Ed

1 Gold, who will both be testifying, Susan Maerki, a project
2 manager with a master's in health economics, in addition to
3 a number of staff members.

4 We worked collaboratively bringing together our various
5 areas of expertise to brainstorm around the questions at
6 hand, make use of our knowledge and capabilities and bring
7 it all together into one single report.

8 Q Would you also please describe the team dynamics among all
9 of the Washington consultants?

10 A Yes. We worked collaboratively with - in addition to the
11 PwC teams, which extended beyond just the Economic Impact
12 Analysis, to tax, the accounting, the executive
13 compensation, the foundation tax issues, were all PwC team
14 members, in addition, Cantilo & Bennett provided the legal
15 aspects of the engagement and Blackstone provided investment
16 banking advice.

17 As we had questions about particular pieces of the
18 question of what would be involved in the conversion, we
19 collaborated amongst ourselves. We shared our reports
20 amongst ourselves to ensure that we weren't making
21 statements that were incorrect.

22 I think I left Dr. Leffler off that list. We were
23 involved in discussions with him, as well, around the areas
24 of his expertise that would play into our analysis.

25 Q Yesterday Mr. Kelly also asked you about Exhibit P-167. And

1 I believe it is one of those binders down below there on the
2 floor. It looks like you don't need any help picking it up.
3 Thank you.

4 Do you have it?

5 A Yes, I do.

6 Q I believe he asked you to comment - or at least talk to him
7 about some language on Page 3 of that exhibit; is that your
8 recollection?

9 A Yes.

10 Q And in particular he directed your attention to some
11 language about - a little bit further than halfway down the
12 page, which says, "Send only to C & B."

13 Would you please explain the context, to the best of
14 your recollection, of that - of that - that entry?

15 A Sure. At the beginning of the engagement there were
16 questions about confidentiality. We had not yet reached a
17 confidentiality agreement with Premera around the documents
18 and our materials and there was some discussion about - at
19 that time of having Cantilo & Bennett serve as essentially a
20 project manager for the entire Washington consulting team.

21 Later - not much later in the engagement that decision
22 was turned around. They were not put into that role. But
23 at the time of this particular conversation, there was still
24 talk of that possibility.

25 And in order to move things forward and maintain

1 confidentiality, we wanted to make sure that we didn't send
2 e-mails, send information that would be subject to
3 disclosure in a way that was inappropriate.

4 Q And what, again, was the date of that telephone conference?

5 A That was December 4th, 2002.

6 Q Then on the next page, Mr. Kelly directed your attention to
7 something at the top of the page, in particular the first
8 two lines, "Rusty Fallis, why a fall deadline. Jim O. PR
9 issue."

10 Why did you write that down?

11 A We were all concerned about the deadlines that had been
12 established in the early part of this project, having been
13 involved in the Kansas case and several of the other
14 advisors having been involved in many of the conversions
15 transactions that have been analyzed over the last several
16 years.

17 And, at that time, I don't believe we had any data or
18 very little data from Premera and did not believe it would
19 be possible to meet the deadlines that were in our contract.

20 Jim was concerned from the beginning that the process
21 move as quickly as possible and wanted to keep that momentum
22 going, but there was a fairly clear recognition by the
23 project team that a 30-day deadline was unrealistic.

24 Q Also you were asked yesterday about operating margin. Where
25 did you get operating margin as a measure versus net income?

1 A In our experience in working with health plans and reviewing
2 health plan performance, there are various measures of
3 performance. One of them is net operating margin and that
4 tells you what the level of profitability is. Others are
5 growth in both revenue and net income. But at the bottom
6 line, profit is what determines how well the plan is doing.

7 Q Is - is this measure unusually - unusual in the - does it
8 have any unusual - is it not used commonly in the - in the
9 healthcare finance industry?

10 A It is used commonly, as well as some of the other measures
11 that I mentioned. But it is a measure that is easy to
12 understand and is fairly readily available to people looking
13 at health plan performance.

14 Q Also yesterday Mr. Kelly talked to you about the amount
15 billed by PricewaterhouseCoopers for the work it has
16 provided in this matter. And he also cited a fee of - I
17 believe it was in the neighborhood of 4.81 million dollars.
18 Do you recall that testimony?

19 A Yes, I do.

20 Q Is this fee only for the Economic Impact Analysis?

21 A No. That fee is inclusive of all of the analyses that we
22 have done. There was some testimony from a number of our
23 project leaders here on accounting and tax and foundation
24 structure and executive compensation. It encompasses all of
25 those.

1 Q Does it encompass more than just preparing the reports?

2 A Yes, it does. It includes all of the review of the
3 documents that we have received from Premera, attending many
4 days of meetings and performing reviews and multiple
5 versions of drafts of documents and so forth.

6 MR. HAMJE: That's all I have. Thank you.

7 MR. KELLY: Just two areas quickly on redirect -
8 recross.

9

10 RECROSS-EXAMINATION

11

12 BY MR. KELLY:

13 Q Ms. Hamburger asked you about the three-year requirement
14 now - and she talked about problems. The problems that you
15 are talking about are ones that supposedly Mr. Staehlin is
16 going to show us on rates and Mr. Gold is going to show us
17 on models; is that correct?

18 A Yes.

19 Q Okay. So if they are not right, those problems aren't right
20 either; isn't that true?

21 A Presumably.

22 Q Okay. And getting back to this question of operating
23 margins that Mr. Hamje raised again, yes, operating margins
24 are used, but in your report you never included the two
25 other more important characteristics of increasing operating

1 income and strong growth even though you were told about
2 them by Blackstone and Goldman Sachs; isn't that true?

3 A In our October report, that is true.

4 Q You didn't put it in your supplemental report either, did
5 you?

6 A I think if you read the conclusions, you will find that
7 there.

8 Q Somewhere in there? Uh-huh.

9 Where in the report?

10 A In the conclusions.

11 Q Where - do you have the report in front of you?

12 A Probably.

13 Q Let's take a look at it.

14 JUDGE FINKLE: What exhibit is that?

15 MR. HAMJE: That would be S-21.

16 MR. KELLY: S-21.

17 Q (BY MR. KELLY) What page are you referring to?

18 A Page 6.

19 Q Okay. What paragraph?

20 A The bottom of the first paragraph.

21 Q Well, you don't relate that to the model, do you?

22 A We do not relate the model, no.

23 Q And the paragraph starts out by talking about a problem with
24 operating margins and does not put it in the context of
25 operating margins as being the least of the three most

1 important - the three important factors, does it?

2 A I - I'm not sure that I believe that it is the least of the
3 most - of the factors, so no, it doesn't.

4 Q Okay. And is it fair to say that you put in the little bit
5 that you did at the end of the paragraph because of the
6 questioning that I had - that I had asked you prior to
7 writing the report?

8 A We did consider the comments that you made, yes.

9 Q Okay. So basically if I had not - or someone had not raised
10 that problem with you, there is no reason to think that --

11 MS. HAMBURGER: Objection. It is argumentative.

12 JUDGE FINKLE: Sustained.

13 Q (BY MR. KELLY) Well, if there - so your having been
14 questioned about that was a factor in bringing any
15 information about increased revenues and growth to the
16 Commissioner's attention; isn't that true?

17 A We did take input from multiple sources in our thinking,
18 yes.

19 Q Great.

20 MR. KELLY: Thank you. Nothing further.

21 MS. HAMBURGER: Nothing further.

22 MR. HAMJE: No further questions.

23

24

25

EXAMINATION

BY COMMISSIONER KREIDLER:

Q Ms. Hunt, I noted that at one point you made mention - and it did come up again in some of the following comments that were - or questions that were asked - and that is relative to Premera's performing like a public company.

Is there any way of separating out Premera's performance in the health insurance market that would differentiate it from other not-for-profit companies?

A Over the past several years Premera has behaved in a manner that in - appears to be moving it towards a public company. One of the characteristics is that looking at the particular population groups that it is covering and very clearly indicating that any subsidy of any line of business is inappropriate.

The pull-out from the Washington Medicaid program, for example, and the sale to Molina is not unusual. There are many companies that are making that choice. And where you see that most often is in the publicly-traded health insurance companies.

There is - a number of years ago many of the public companies did have a significant participation in Medicaid and there has been some very strong documentation of the pull-out from those kinds of programs from public companies.

1 That's one indication.

2 The very strong focus on profitable growth is another.
3 None of them wrong or incorrect, but just a different
4 characteristic of a company.

5 Q How would you generally characterize not-for-profit
6 companies' behavior in the market that would somewhat
7 separate them generally from the for-profit companies and
8 what would be their motivations if they were staying in
9 markets where arguably they were perhaps small market share
10 and not too profitable and the like?

11 A I'm not sure if I followed your whole question, but I will
12 try.

13 Q Let me phrase it another way.

14 I'm looking - trying to have some idea of what the
15 characteristics are for a not-for-profit company that
16 differentiate from a for-profit company. You touched on
17 that. But I'm more interested in what may be the
18 motivations of a not-for-profit company. Is it if they are
19 not being driven as much as a group by the bottom line, what
20 are they more motivated toward?

21 A Well, at least looking into the more recent past in many
22 not-for-profit health insurance companies, you see, perhaps,
23 less tight underwriting - excuse me - on individuals, a
24 means of extending health insurance coverage to individuals
25 who might not be offered health insurance coverage by a

1 for-profit because they would be deemed to be an
2 unprofitable individual. Motivation - motivation would come
3 from their view of their role in the market and what their
4 responsibility is to the community to provide health
5 insurance as broadly as possible.

6 Q Very good.

7 COMMISSIONER KREIDLER: Thank you very much.

8 JUDGE FINKLE: Any follow-up?

9 MR. HAMJE: We have no follow-up.

10 MR. KELLY: Just a couple if I may.

11
12 REDIRECT EXAMINATION

13
14 BY MR. KELLY:

15 Q First, were you here yesterday when Mr. Nemerov and I were
16 talking about the serious financial situation that Premera
17 was in just a few years ago?

18 A I was here for his testimony.

19 Q Okay. Remember I put the negative - was it 20 million? - up
20 on the board that they were losing money?

21 A I saw that number, yes.

22 Q So for-profit and not-for-profit, certainly if they want to
23 stay in business, have to look to make money, do they not?

24 A Yes, they do.

25 Q Okay. And you said that you are seeing public companies

1 pull out of Medicaid; is that your argument?

2 A Yes.

3 Q Okay. So, again, this is sort of a description of what you
4 see around based upon your experience?

5 A That's right.

6 Q Okay. Are you aware that Group Health pulled out of
7 Medicaid in Eastern Washington?

8 A I - I don't recall. I don't know the answer to that.

9 Q Do you - are you aware that Regence pulled out of Medicaid?

10 A I - again, I don't know the answer to that.

11 Q Are you aware that Regence dropped its Basic Health Plan
12 program for a time?

13 A I don't recall that.

14 Q Didn't Group Health drop out of the counties in Eastern
15 Washington in regard to its Medicaid program?

16 A I think it did, yes.

17 Q Okay. So isn't, by your definition, Group Health acting
18 just like Premera?

19 A In some areas, yes.

20 Q Okay. Do you think it might be better to rely on economic
21 laws rather than interpretations of psychology to
22 ascertain what the - what the companies are doing?

23 MS. HAMBURGER: Objection. It is argumentative.

24 JUDGE FINKLE: Overruled.

25 Q (BY MR. KELLY) You can answer.

1 A I think I need you to restate that.

2 Q Are you talking about your sense of what you thought Premera
3 was doing in interpreting what was - its decisions that were
4 likely to be based upon economic analysis of what it could
5 afford and not afford to do?

6 A I think it is a combination. I don't think it is black and
7 white.

8 Q Okay.

9 MR. KELLY: Okay. That's all I have. Thank you
10 very much.

11 MR. HAMJE: No further questions.

12 JUDGE FINKLE: Thank you. Please step down.

13 MR. HAMJE: May this witness be excused?

14 JUDGE FINKLE: She may.

15 THE WITNESS: I assume someone is going to get
16 these.

17 MR. HAMJE: Your Honor, may I approach and help to
18 remove that mound?

19 JUDGE FINKLE: You may.

20 MR. ELLIS: At this time, the OIC staff will call as
21 its next witness Dr. Keith Leffler.

22

23 DR. KEITH LEFFLER, having been first duly
sworn by the Judge,
24 testified as follows:
25

1 JUDGE FINKLE: Please sit down.

2 THE WITNESS: Thank you.

3

4 DIRECT EXAMINATION

5

6 BY MR. ELLIS:

7 Q Would you state your name for the record, please,.
8 Dr. Leffler?

9 A Yes, it is Keith V. Leffler.

10 Q Where are you employed and in what positions?

11 A I'm employed at the University of Washington as an associate
12 professor of economics.

13 Q Will you tell the Commissioner a little about your
14 background and yourself?

15 A Yes. I received my Ph.D. degree in economics from
16 University of California Los Angeles. My first job out of
17 graduate school was at University of Rochester, director of
18 management, went there in 1975. Had the opportunity to come
19 back to the west coast where I was born and raised and came
20 to the University of Washington in '78. And it has now
21 shocking to think that that's almost 30 years.

22 Q And do you have any specific specialities in your work as a
23 professor of economics at the University of Washington?

24 A I do. My thesis was on - titled, "Competition of Monopoly
25 in American Medicine," and it concerned basically

1 competitive issues in physician services supplies. And I
2 have since specialized in antitrust issues, both in the
3 healthcare area and many other industries also.

4 Q Your prefiled direct and responsive testimony have been
5 served and filed in this proceeding, haven't they?

6 A Yes.

7 Q Do you adopt that testimony?

8 A I do.

9 MR. ELLIS: The OIC staff offers Exhibits S-16,
10 which is Dr. Leffler's CV, S-17, which is his report, and
11 S-18, which is his supplemental report.

12 MR. TAUSEND: No objection.

13 MS. HAMBURGER: No objection.

14 JUDGE FINKLE: Admitted.

15 MR. ELLIS: In addition, we offer S-53, which is
16 Dr. Leffler's prefiled testimony, and S-54, which is his
17 prefiled responsive testimony.

18 MR. TAUSEND: No objection.

19 MS. HAMBURGER: No objection.

20 JUDGE FINKLE: Admitted.

21 Q (BY MR. ELLIS) Now, Dr. Leffler, you were retained in this
22 proceeding by the Attorney General's office and the OIC to
23 evaluate antitrust issues raised by the proposed conversion,
24 were you not?

25 A Yes.

1 Q How long have you worked as an economist in antitrust
2 matters? You mentioned that you specialize in them
3 currently.

4 A Well, beginning when I was still in graduate school, so
5 about 30 years.

6 Q Your CV shows that in the past four years you have testified
7 at trial or in depositions in 28 different cases. How many
8 of those cases required you to provide your evaluation of
9 the market definition and market power?

10 A Yes. Those were mostly deposition testimony, but in
11 probably 90 percent of the issues I'm involved in, both in
12 my research, which flows from my antitrust work, and the
13 antitrust work itself, the issue of market definition is
14 primacy as is the issue of market power, so most
15 certainly --

16 Q And your CV also lists, I believe, 16 different instances in
17 which you have consulted - consulted with the Federal Trade
18 Commission or the Department of Justice. Would you give the
19 Commissioner an overview of what those consultations
20 involved?

21 A Well, they - they - range widely, but the Department of
22 Justice and the FTC probably spend - absent the criminal
23 divisions, the antitrust division spends a lot of their time
24 in merger activity and that's certainly where the bulk of my
25 work with those agencies has been. So it has ranged from

1 oil mergers to hospital mergers to mergers in the computer
2 industry. It has been - and they are listed on the CV.

3 Q And over what time period did those 16 consultations take?

4 A The first time I worked for one of the federal agencies I
5 recall it was the - when Chevron acquired Gulf Oil, which at
6 the time was the biggest merger that had happened
7 historically. Now, it is dwarfed by others. But that was
8 in the late '70s or very early '80s.

9 Q And is the listing of the FTC/DOJ Microsoft case one of the
10 most recent cases that you have worked on?

11 A Well, it began in 1990. I worked for the FTC who was
12 investigating - had the investigation at that time and then
13 the Department of Justice took it over, so the answer is
14 kind of yes and no. It began a long time ago, but it only
15 ended recently.

16 Q And what was your role in the FTC investigation and the
17 Department of Justice case?

18 A I was the primary economic consultant to the FTC and then
19 continued a consulting relationship with a number of other
20 economists when the Department of Justice took over the
21 case.

22 I certainly was involved, for example, in defining the
23 relevant market and assessing Microsoft's market power and
24 the agencies with respect to that.

25 Q And was the Department of Justice case the case that was

1 brought alleging monopolization and other violations by
2 Microsoft and also involved in 19 states?

3 A Yes. I was not involved in the state's part of the case,
4 but only the Department of Justice case. But, yes that is
5 ultimately what happened in those investigations.

6 Q Now, turning to your work in this proceeding, as Ms. Hunt
7 has described, PwC has also been doing work on the economic
8 evaluation of this proceeding.

9 Could you give the Commissioner a brief overview of the
10 relationship between your work and the work being done by
11 PwC?

12 A Yes. In particular, it is easier for me to describe what I
13 felt I had to contribute possibly. And that's that in the
14 merger evaluations they involve the area of where is the
15 area of effective competition, what is the structure of the
16 industry, who are the competitors, how might that affect
17 pricing. So I, in consultation with you, said that I think
18 perhaps I can contribute some understanding in that area.

19 Unlike most of the work I do, I realized here that there
20 was really no change in the structure of the market, that
21 any changes or any impacts on - on competitive results were
22 far subtler involving the conversion to for-profit. So I
23 realized that's not something I'm an expert in and then PwC
24 took it, if you will. I set up the analysis of the market
25 and market power and they went from there.

1 Q And during your investigation, what sources of information
2 did you turn to?

3 A I had access to the - all the discovery, the documents and
4 material that Premera provided to the OIC. So I and my
5 staff, with the assistance of the Attorney General's office,
6 went through that and pulled out things that would be of
7 interest from the understanding of the general marketplace.

8 I then sought and obtained ultimately extensive data
9 both from the OIC, from Premera and from third parties. I
10 had and directed a number of interviews, I think 50 or so
11 interviews done by the - Attorney General's office staff of
12 all participants in the marketplace; brokers, insurers,
13 providers, medical societies, certainly interviewed
14 extensively and cooperated with the staff of the OIC.

15 And then, finally, I had access to and the ability to
16 interview particular manufacturers and executives at
17 Premera.

18 Q What were the issues that you addressed during your
19 investigation?

20 A I was interested in determining the areas in which and the
21 products in which Premera was competing, who they were
22 competing with, where they were competing in order to assess
23 whether they had any particular dominance in any areas.

24 And then I was interested - depending on my answer to
25 that question, interested in then assessing whether they had

1 any market power.

2 Q How do economists define market power?

3 A In this context, market power would simply ask the question
4 does Premera - is Premera in a situation such that they
5 might be able to charge prices above the competitive level
6 in the selling of insurance policies. And in this
7 particular market there is a question on the other side, and
8 that is is Premera in a position where it might be able to
9 control or offer reimbursement rates to providers that are
10 below what otherwise would be in a competitive marketplace.

11 Q And how did you approach the question of whether Premera has
12 market dominance?

13 A I began by trying to identify the area of effective
14 competition so that I could then determine to - hopefully
15 information that would describe their position in that area
16 of effective competition.

17 Q And how did you define the area of effective competition?

18 A Formally people in my line of work call that defining the
19 relevant economic market. And I followed the same type of
20 analysis I have done in many other situations and the type
21 of analysis that has been conveyed to writing, if you will,
22 in the guidelines followed by the Department of Justice and
23 the Federal Trade Commission in assessing competitive
24 impacts of various situations that might occur.

25 Q Dr. Leffler, I'm going to hand you a document that has been

1 marked as Exhibit S-64 and ask to you look at that.

2 A Thank you.

3 Q Did you prepare this document, Dr. Leffler?

4 A Well, I pulled this off the Internet where the guide -
5 Horizontal Merger Guidelines of the Federal Trade Commission
6 and the U.S. Department of Justice are readily available.
7 It is certainly something I look at all the time. So, yes,
8 I pulled it off and put it so that we could print up a
9 little excerpt.

10 Q And is the market definition that is described in this
11 document the approach that you used in defining the relevant
12 market in this case?

13 A It is. Perhaps I could just - the paragraph that the
14 Commissioner has before him is relevant - sort of technical,
15 but all it really says is a market - a relevant economic
16 market in areas of effective competition describes a set of
17 products that if somebody controls them, they are able to do
18 well.

19 I say to my students, well, the relevant economic market
20 is something if you were the only seller in it, you would be
21 rich, you would do well, you would be able to charge higher
22 than a competitive price.

23 Q And there is a reference in this exhibit to demand
24 substitution factors. Could you give the Commissioner a
25 simple overview of what that refers to?

1 A Yes. What you are referring to is the sentence on the
2 bottom. It says, "The market definition focuses solely on
3 demand substitution factors, i.e. possible consumer
4 responses."

5 What we are trying to do here is assess whether a
6 company has dominance in a marketplace because that is a
7 necessary condition for them to have the ability to control
8 prices. So we begin with that and we are trying to come up
9 with a means of quantifying somehow presence in the
10 marketplace in order - and we will talk about market shares
11 in a minute.

12 But in order to do that, we have got to have a
13 denominator and that is know how much Premera sold of
14 things. We have to know what to divide it by in order to be
15 able to assess their position.

16 And so what we are really asking here is we want to make
17 sure we include in everything that if the price went up,
18 could consumers simply go elsewhere to buy a product and if
19 so, you could obviously control the price.

20 For example, if I controlled all the gas stations in
21 Tumwater, would I have market power? Would I potentially
22 have market power? I think clearly the answer is no.
23 Because people would buy gasoline in Olympia and Lacey. And
24 so we have to expanded the market to include a bigger area
25 in that case.

1 Would I say I had market power if I controlled mid-grade
2 gasoline? Obviously not, because if the - we go - so we
3 want to look at where consumers would return to if, in fact,
4 they faced prices that weren't competitive and if they can
5 readily turn elsewhere, that belongs in the relevant
6 economic market.

7 Q And to what extent during those numerous consultations with
8 the FTC and the Department of Justice did you use a
9 different approach to defining market power than you used in
10 this proceeding?

11 A I fundamentally have used this approach since the mid 1970s.
12 The process of these guidelines was one of consultation with
13 economists and lawyers to come up with kind of practice, if
14 you will, the way that it is properly done. So I have been
15 doing this both for them and other cases throughout my
16 career.

17 Q What conclusions did you reach about the appropriate
18 definition of relevant markets in this proceeding?

19 A I concluded that the proper market definition in which to
20 assess Premera's dominance would be the sale of commercial
21 insurance in regions within the State of Washington and, in
22 addition, that a relevant economic market to look at would
23 be the purchase of provider services for
24 commercially-insured patients in regions in the State of
25 Washington.

1 Q And when you referred to commercial insurance, what are you
2 - on the selling side to begin with, what are you referring
3 to?

4 A Fundamentally the sale of insurance policies to individuals
5 to small groups and to large groups as contrasted to Basic
6 Health Plan or other state- or federal-subsidized insurance
7 plans, Medicare, Medicaid, Basic Health Plan.

8 Q What did you mean when you referred to the sale in regional
9 areas in Washington?

10 A I might expand a little on that at some point, but basically
11 we are asking where people will go to purchase their
12 healthcare. So that if I'm a small group employer in
13 Spokane and I face a high price, it would not be an option
14 for me to buy insurance that offered coverage - or provider
15 networks in Seattle. My - my employees are not going to
16 drive there to get their healthcare or most of their
17 healthcare.

18 The reason I say regional is it turns out there is no
19 need for me to be exact with the specifics of the regional
20 markets. But in Eastern Washington, for example, the
21 Spokane metropolitan area would be a relevant geographic
22 market. If you went to much more rural areas, if you talked
23 about Ephrata, that is probably more relevant, particularly
24 Grant County or something like that.

25 So I say regional just to - to focus on the fact that

1 the State of Washington as a whole is much too large of an
2 area to be talking about where consumers can turn to
3 alternatives. And as we will see the data on dominance, it
4 doesn't matter whether you define it very finely or not.
5 You get the same answer whether you look at a set of
6 counties, an individual county, a metropolitan area.

7 Q Why did you exclude governmental coverage from your
8 definition of the relevant market?

9 A Clearly to an employer seeking coverage for his employee
10 group or to an individual seeking coverage on their own, for
11 nearly everybody in that situation, a Basic Health Plan -
12 a - they would not qualify for a Basic Health Plan, a
13 Medicaid plan or a Medicare plan, so that they are limited
14 to a segment of the marketplace when they are searching out
15 the products that would be useful for them to offer their
16 employees or to offer themselves.

17 Q In defining the relevant market, did you consider whether a
18 governmental carrier like Molina might enter the commercial
19 market and provide an alternative to consumers?

20 A Not in defining the relevant economic market. The - the
21 issue I'm interested in here is defining a market where it
22 can measure dominance. Having measured dominance, I have
23 further work to do.

24 But I have to investigate as to whether or not even if
25 Premera is dominant or is the only insurer in a particular

1 segment of the marketplace. If it tries to raise prices,
2 can others quickly and easily enter? If so, I would
3 conclude they don't have market power.

4 But the step is sequential. First, let's define the
5 current area of effective competition, the current
6 competitors and then if Premera is not dominant, we have no
7 other concerns, we can - I would conclude they have no
8 market power. If they are dominant, I will go on, see what
9 other constraints they might face, and that might include
10 entry of someone like Molina.

11 Q Dr. Leffler, I'm going to hand you a document that has been
12 marked as Exhibit S-112 and ask you to review that.

13 Can you tell the Commissioner what this document is?

14 A Yes. It's a table contained within my prefiled testimony.
15 It's based on OIC data. It's based on what - at the time I
16 did it, it was the latest reliable OIC data and it
17 fundamentally just tells us what percent of members of
18 various plan types Premera insures in every county in the
19 State of Washington. And I have broken it up into a couple
20 subareas within the state.

21 Q And why did you list these market shares by county?

22 A That's the way - that's the finest level at which the data
23 is available.

24 Q Did you draw any conclusions from this data about Premera's
25 market dominance?

1 A I did. In particular, let me focus on the bottom part of
2 the table, which is Western Washington.

3 MR. TAUSEND: Your Honor, counsel is asking
4 questions about exhibits and he is not offering them, which
5 gives us no chance to object.

6 MR. ELLIS: I will offer Exhibit S-112.

7 MR. TAUSEND: May I ask a voir dire question?

8 JUDGE FINKLE: Yes.

9

10 VOIR DIRE EXAMINATION

11

12 BY MR. TAUSEND:

13 Q Dr. Leffler, are you defining, then, markets on this exhibit
14 as by lines of business, as a separate market, individual
15 and small group and large group? Is that part of your -
16 part of the - your market definition?

17 A It is not an easy yes or no is the problem. I wish I could
18 say yes or no. There is certainly distinctions with large
19 group that are not present with individual and small group,
20 so that I have put them separately in order to point out
21 distinctions within them. At the same time - and the shares
22 are so similar that I don't have to make fine distinctions,
23 so yes and no.

24 Q One more clarifying question.

25 JUDGE FINKLE: Just for the mic - I know you are

1 used to standing.

2 MR. TAUSEND: I see. That's right. That is my
3 years in court. I understand, Your Honor.

4 JUDGE FINKLE: Thanks.

5 Q (BY MR. TAUSEND) And in these Premera market shares, in
6 Exhibit S-112, you don't include self insurance?

7 A No, that's - in fact, when I said there are distinctions
8 about large group, that was going to be exactly the
9 direction that I was going to clarify. Self-insured is not
10 included in this table and that mainly affects large group,
11 or supposedly large group.

12 MR. TAUSEND: That's all I have on voir dire. I
13 will save the rest for cross-examination.

14 This clarified, we have no objection to S-112 as
15 reflecting what his testimony is going to be.

16 JUDGE FINKLE: Did you say that this is a part of
17 prefiled testimony? If so, has it already been admitted?

18 MR. ELLIS: I don't recall whether this has.

19 THE WITNESS: It is assembled somewhat different.

20 MR. ELLIS: Yes.

21 THE WITNESS: The data is there, but it is organized
22 slightly different.

23 JUDGE FINKLE: Any objection from the Interveners?

24 MS. HAMBURGER: No objection.

25 JUDGE FINKLE: Admitted, 112.

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DIRECT EXAMINATION

(Resumed)

BY MR. ELLIS:

Q Dr. Leffler, why is self insurance not reflected in these market shares numbers in Exhibit S-112?

A There is incomplete reporting to OIC with respect to self-insured.

Q And getting back to my previous question, did you draw any conclusions from this data concerning Premera's market dominance?

A Yes. My first and easiest conclusion is Premera has no market dominance in Western Washington and that, in fact, my inquiry into Western Washington - because I concluded that from that, therefore, they have no market power regardless of any other conditions in the marketplace.

I then looked at Eastern Washington and quickly noted some areas in Eastern Washington where Premera's share was generally relatively high shares in Eastern Washington, but some areas with relatively low shares. And certainly from my interviews, I was aware of the fact that there was a distinction in Eastern Washington, because in most of Eastern Washington Premera controlled both the Blue Shield and the Blue Cross name, but in parts of Eastern Washington

1 they did not, where in parts of Eastern Washington Regence
2 had maintained the right to market under the Blue Shield
3 brand name. And, in fact, their Idaho Blue Shield also had
4 the right to market under the Blue Shield in other parts of
5 Eastern Washington.

6 So what I have done here is broken out Eastern
7 Washington into those counties where Premera has both the
8 Blue Cross and the Blue Shield brand name and those counties
9 in Eastern Washington where they do not.

10 I have concluded that generally the market shares where
11 they face the competition of another insurer with the Blue
12 Shield leads to them not having dominance. So I focused on
13 the remaining 14 counties in the table, which the
14 Commissioner has. It is the upper part of the table.

15 And there we see that their market share on average in
16 those 14 counties for individual and for group policies is
17 over 90 percent. And that's why I said earlier that exactly
18 how you slice and dice these areas that represent proper
19 regions doesn't make any difference, because you get very
20 high market shares any way you do it indicating dominance in
21 that sense.

22 In the large group market, the share is quite a bit
23 smaller and it does not consider self-insured. And, in
24 fact, for my analysis, I have concluded that the - the
25 availability of self-insurance for large groups alleviates

1 any concerns about the exercise of market power independent
2 of what the particular market share figure would be.

3 Q So what were your conclusions with regard to whether Premera
4 has market dominance on the selling side?

5 A That they, in fact, have market dominance in the sale of
6 individual and small group policies in the 14-county area of
7 Eastern Washington or - where they do have the right to
8 market under the Blue Shield, which I will just call the
9 "14-county area."

10 Q Did that conclusion tell you anything as to whether Premera
11 has market power in those 14 counties?

12 A It does not. It is a necessary condition to have market
13 power, but it is not a sufficient condition at all. So I
14 need to go on and look further now. In fact, they have
15 dominance, they might have market power, they might not.

16 Q And when you go further, what do you look for?

17 A Fundamentally, I'm turning to the question you asked me
18 earlier and that is is their ability to exercise any control
19 over the price in that marketplace effectively constrained
20 by the possibility of other people coming in and entering in
21 response to any such attempt. So I now look at the
22 possibility of entry.

23 Q Were you able to determine whether there are any impediments
24 that would prevent other firms from entering and
25 constraining Premera's market power in those 14 counties?

1 A Yes. In particular, in the initial interviews I did with
2 other insurers and with brokers and with employers, there
3 was an emphasis on switching costs and particularly that
4 employers indicated that their employee groups would be very
5 upset if in reaction to a relatively - say, a five percent
6 or so price increase, if their employees had to give up the
7 providers they were with, their family doctors and things
8 and switch to other providers as a consequence of switching
9 insurers. So the switch cost - so the first impediment to
10 entry is the necessity for another entrant to come in and
11 offer a network that essentially mimics the Premera network.

12 In addition to that, the employers also emphasized the
13 paperwork burdens of dealing with health insurance and that
14 even faced with a price increase, certainly not too large of
15 a price increase, but they would rather than get involved in
16 a whole new system and a new insured, that they would put up
17 with some price increases before they would switch.

18 In addition to that, particularly in the rural areas of
19 Eastern Washington, the markets are so small that if an
20 insured does not have established relationships with
21 brokers, a sales network, it is very unlikely a price
22 increase in, say, the five to ten percent range in those
23 areas is going to motivate setting up that administrative
24 apparatus. So certainly those were - were impediments that
25 came out in the various work I did.

1 Q Were there any other impediments that you identified?

2 A Yes. I have already mentioned it really, but I will just
3 reemphasize it. And that's that Premera is in a situation
4 of controlling both the Blue Shield and the Blue Cross brand
5 name in that area and those brands clearly have substantial
6 asset value, which is just another way to say that they are
7 recognized and have value in the marketplace so that they
8 begin with a leg up, an advantage that others won't have in
9 the marketplace.

10 Q Did you do any further analysis concerning the effect of
11 Premera's having the Blue trademark?

12 A Yes. I think it is manifested on the Exhibit S-112 that you
13 gave me earlier, when you compare the average market shares
14 in the areas where they have both brands and where they only
15 have the one brand in Eastern Washington. And I also looked
16 at Regence, who as I mentioned earlier, in fact, controls
17 the Blue Shield plan in three counties in Eastern
18 Washington.

19 So I just looked at how has their success been when they
20 have that Blue Shield and as compared when they sell under
21 the Asuris name absent the Blue Shield.

22 Q And what did you find when you examined those results by
23 Regence?

24 A I found that Regence was far more successful when they had
25 the Blue Shield. On average they had a share of about 30

1 percent in the counties where they had the shield in Eastern
2 Washington and a share of only about six percent when they
3 did not, which I think just indicates the value of that
4 brand name.

5 Q Are you aware of the conclusions by Premera's economist
6 Dr. McCarthy that entry into Eastern Washington is easy?

7 A Yes.

8 Q Did you examine any of the evidence relating to his
9 conclusions to determine whether you agreed with him?

10 A Yes. Dr. Murphy offered both in his report and in
11 testimony --

12 Q Dr. McCarthy, I believe.

13 A -- excuse me, Dr. McCarthy, yes - offered examples that he
14 felt indicated how easy it was to enter and I examined those
15 examples. The four examples he had of the - that he
16 referred to as successful expansion into Eastern Washington
17 were King County Medical that was talked about with Ms. Hunt
18 just earlier today.

19 King County Medical was not entry at all. King Count
20 Medical acquired an existing insurer and simply perpetuated
21 that business. So that's not what an economist means when
22 you use examples of entry. It means someone coming into the
23 commercial insurance who wasn't there before.

24 He offered the example of FirstChoice. FirstChoice did
25 enter and did fail. That's not an example of successful

1 entry.

2 There was an example of New York Life Care. I heard
3 issues about the actual numbers. My analysis of the data
4 indicates to me that New York life is not an example of
5 successful entry because they insure very few members in the
6 small and the individual segments of the - of the insurance
7 market in the 14 counties of Eastern Washington, so that's
8 not an example.

9 And the last example was Northwest One, who is simply
10 not an insurer. So if you offer four examples, none of
11 which, in fact, are examples, so in my view there is no
12 example of successful expansion into Eastern Washington.

13 Q Did you examine the evidence relating to his conclusion that
14 there have been significant product line expansions that
15 show that entry is easy?

16 A Yes. He offered, again, testimony here at this hearing in
17 which if you look at his - his data and his slides, he
18 offers six examples that he says indicate what he calls
19 product line expansions into Eastern Washington. That would
20 be an example - this is not such an example, but it would be
21 - if it were true, it would be like Molina getting into the
22 small group market in Eastern Washington.

23 His examples involve FirstChoice, who has not been
24 successful. And FirstChoice was always in the commercial
25 segment, so that can't be an example of - Aetna who has

1 always been in the commercial segment, that they simply
2 offer a slight different policy. Regence has always been in
3 the commercial market, slightly different policy.
4 PacifiCare who has entered, I understand, the small group
5 market in Western Washington, haven't been successful, but
6 they have not done it in Eastern Washington. And then
7 Asuris, again, a commercial insurer.

8 So I find no examples of successful expansion into
9 commercial insurance from product line extensions from an
10 existing insurer who is in state offering commercial
11 insurance in Eastern Washington who was not offering it
12 previously.

13 Q Did you reach a conclusion as to whether Premera has market
14 power as a seller of insurance?

15 A Yes. I reached the conclusion that they have some market
16 power in the sale of individual and small group policies in
17 the 14-county area of Eastern Washington.

18 Q Did you reach a conclusion as to whether they have exploited
19 that market power?

20 A I did. I concluded that they have not exploited that market
21 power.

22 Q What did you base that conclusion on?

23 A Fundamentally both the procedures that Premera uses in
24 pricing their policies and the OIC's regulations and
25 controls over their pricing the policy.

1 I'm only - I'm looking merely for the market definition
2 slide. I'm just pointing out that it does say within it in
3 defining this market as a phrase not subject to price
4 regulation. So in this particular market there is something
5 akin to price regulation.

6 So, for example, in the individual market Premera prices
7 statewide, what that means is their price is going to be
8 mainly affected by and determined by the western side where
9 most of the population is and where I concluded there is
10 competition. So that individual price will be constrained
11 by competition in Western Washington.

12 And the small group market, the OIC has detailed
13 regulations concerning the extent to which an insurer can
14 vary rates across geographies. And here we have a situation
15 where I'm finding different market powers geographically and
16 the exercise of that power is being constrained by basically
17 the requirement to pass on costs advantages.

18 And then, finally, I already talked about the large
19 group, where self-insurance is a reasonable alternative for
20 any significant-sized employer.

21 Q Turning to the buying side, did you continue your
22 investigation to determine whether Premera has any market
23 power on the buying side?

24 A I did. And, again, we have defined what we mean by a market
25 for the purchases of provider care where I have concluded

1 that is the purchase of provider services for commercial
2 insured patients. And I will limit now to the 14-county
3 area of Eastern Washington because that's the only area
4 that - in which there might be such power.

5 Q And on the buying side, why do you include
6 commercially-insured as an element of the relevant market?

7 A Those tend to be the patients that providers need, if you
8 will, those are the profitability patients. Those are the
9 patients that reimburse at the highest levels in contrast to
10 cash-paying payments for which there are tremendous
11 uncollected bills, governmentally-funded patients where the
12 government has been very effective in constraining the
13 provider's ability to set their mutual rates. So it is the
14 focus on what I call the profitable, desired segment of the
15 population.

16 Q And in your definition of the relevant market on the buying
17 side, what regional markets are you referring to?

18 A Well, again, it is the places where people will go to get
19 their healthcare, so the Spokane metropolitan area, the
20 Wenatchee metropolitan area, the Tri-Cities areas.

21 And, as I say, when we get to the rural areas it becomes
22 a broader area, but a county - or a county and its
23 neighboring counties.

24 Q Did you determine what Premera's market share is on the
25 buying side in those 14 counties?

1 A I did. And I lumped them together since, as we saw in the
2 exhibits, the shares of the commercially-insured patients,
3 which is given in S-112, don't vary tremendously across
4 counties.

5 And so looking at a whole, I found that Premera controls
6 73 percent of the commercially-insured patient population in
7 that 14-county area, a figure that would indicate dominance
8 in that market.

9 Q Does that 73 percent include self-insured?

10 A It does not. There is no good data on that, but
11 Dr. McCarthy did offer some testimony here that estimated
12 the number of self-insured people in Eastern Washington. I
13 simply allocated that among counties and estimated that
14 Premera's share, including self-insured, is about 70
15 percent, so it is not affected much by that.

16 Premera is a substantial presence the self-insured
17 market. It turns out that its share in self-insured is
18 about the same as the share not including self-insured.

19 Q Did you reach any conclusion as to whether Premera has used
20 its dominance in those 14 counties on the buying side?

21 A I did. In the - in the interviews I conducted with the
22 people over in Eastern Washington, both the competing
23 insurers and the providers were - at the top their list was
24 always discussions of how their rates of - reimbursements
25 rates get pressed by Premera, how they - as insurers they

1 have difficulty competing because they are paying more for
2 the providers' services.

3 But I wanted to go on and look at the data, so I did. I
4 collected data both from Premera and I collected data from
5 FirstChoice and I collected data from Regence that allowed
6 me to compare the actual reimbursement rates.

7 Q Dr. Leffler, I'm going to hand you a document that has been
8 marked as Exhibit S-115, which consists of the segment you
9 were referring to on the Spokane reimbursement addendum in
10 2002 in the lower section referring to preferred provider
11 fees.

12 And I should note that this document has been designated
13 as attorneys' eyes only and Mr. Tausend has advised us that
14 the lower - the numbers in the lower portion of the document
15 are confidential. And, as a result, I'm going to ask you to
16 not refer to any of the numbers in the lower portion of this
17 document.

18 Dr. Leffler, can you identify Exhibit S-115, please?

19 A Yes, this just summarizes the analysis I did of
20 reimbursement rates.

21 MR. ELLIS: We would offer Exhibit S-115.

22 MR. TAUSEND: With - this is not part of his
23 prefiled testimony, is it?

24 MR. ELLIS: It is included in his report, I believe,
25 and is part of his prefiled testimony in that way.

1 MR. TAUSEND: I'm going to object on the grounds
2 that it is just a summary of his testimony and his testimony
3 is in and, as I recall, you have not yet been admitting
4 summaries of testimony as such.

5 JUDGE FINKLE: Well, if I look at his prefiled
6 testimony, am I going to see exactly this? I'm not clear on
7 how this relates.

8 MR. ELLIS: Let me ask Dr. Leffler a question to
9 clarify that.

10 Q (BY MR. ELLIS) Dr. Leffler, is the data that you have
11 included in both the A section and B section of this
12 document in the same format that you presented data in your
13 prefiled testimony in your report?

14 A You will find all these numbers in the report. You will not
15 find it in a handy convenient fashion.

16 MR. ELLIS: So, again, on that basis, we believe it
17 is appropriate to have this more convenient format for this
18 data, even though the data may be in his report.

19 JUDGE FINKLE: Is this a newly marked exhibit?

20 MR. ELLIS: No, it is not, Your Honor. This exhibit
21 was submitted and served on the parties back in April by the
22 deadline for submitting exhibits.

23 MR. TAUSEND: It is - I don't claim it is newly
24 admitted. It is not part of his report and I'm just basing
25 my objection on when we offered Premera 35, which was

1 illustrative exhibits similar to this in connection with
2 Dr. McCarthy's testimony, you did not admit them, Your
3 Honor, unless on cross-examination, as was the case with
4 Mr. Coopersmith, he actually brought them in and examined
5 him on it. So I think it follows that same route.

6 JUDGE FINKLE: Well, if I'm recalling correctly, I
7 thought those were summaries of testimony and slides which
8 outlined the testimony as opposed to factual summary, which,
9 of course, has been part of many reports on both sides, so I
10 am going to admit the exhibit.

11 Let me ask about how much longer you expect to be on
12 your direct examination.

13 MR. ELLIS: I believe five minutes, Your Honor.

14 JUDGE FINKLE: Why don't we conclude the direct and
15 then take a break.

16 Q (BY MR. ELLIS) Dr. Leffler, would you explain, first of
17 all, the portion A of Exhibit S-115 referred to as the
18 "Spokane Reimbursement Index 2002"?

19 A Yes. As I mentioned, I obtained data from FirstChoice and
20 Regence and Premera as to their reimbursements in the
21 Spokane area. I was able to find common procedure codes -
22 123 codes - so I could directly compare them. And this just
23 summarizes the results.

24 I found, in fact, that Premera was paying for those 123
25 codes - taking a simple average - paying significantly less

1 to physicians. I then looked at Premera's top 25 procedure
2 codes and while the difference goes down, I still find
3 Premera is reimbursing at a significantly lower rate.

4 Q And, again, without referring to the numbers, turning to
5 Section B of the exhibit, what work did you do to develop
6 these numbers?

7 A This is from Premera data exclusively and it refers to all
8 of Eastern as opposed to all of Western Washington and in
9 their - this is small group - this is from Premera's small
10 group filing to the OIC in which I noted that data was
11 available that, in effect, provided the average discount
12 from the provider's normal fees.

13 So I simply summarized that here where the - the - what
14 is important to me is the finding that the discount is
15 significantly higher in Eastern than in Western Washington,
16 which correlates to the fact that they control a much
17 greater percentage of the patients, the commercially-insured
18 patients in Eastern Washington. So it offers some evidence
19 of their success in getting better rates from the providers.

20 Q Did you draw any overall conclusions from this - the numbers
21 reflected in this exhibit with regard to Premera's
22 exercising market power on the buying side?

23 A Yes, that they had some market power and that they had
24 exercised that market power to some degree.

25 Q Referring to Section B of this exhibit, did you do anything

1 to verify whether the difference from normal fees shown
2 there reflect actual discounts?

3 A I did. It's - it's subtle enough and the filings are
4 voluminous enough and written in not - what I would call not
5 standard English that I wanted to verify with Premera that I
6 was understanding properly the information there, so I asked
7 them.

8 Q I'm going to show you a copy of Exhibit S-81 and ask you to
9 identify that.

10 A This is the question I had submitted to Premera. It
11 essentially says am I properly interpreting the differences
12 reflecting discounts to provider rates and Premera responded
13 to me that this interpretation is correct.

14 MR. ELLIS: I will move the admission of Exhibit
15 S-81.

16 MR. TAUSEND: No objection.

17 MS. HAMBURGER: No objection.

18 JUDGE FINKLE: Admitted.

19 MR. ELLIS: I have no further questions.

20 JUDGE FINKLE: Okay. Let's take a break.

21

22 (Brief recess.)

23

24 JUDGE FINKLE: Ready when you are, Mr. Tausend.

25 You might move the mic just a bit closer to you,

1 Mr. Tausend.

2 MR. TAUSEND: Actually, I have - I have got that
3 just in case I stand.

4 JUDGE FINKLE: It may need to be up, judging from a
5 previous witness, just a little higher on your tie there.

6 Thanks.

7 MR. TAUSEND: Does this do it?

8 JUDGE FINKLE: That does.

9

10 CROSS-EXAMINATION

11

12 BY MR. TAUSEND:

13 Q Good morning, Dr. Leffler?

14 A Good morning.

15 Q Let me start with some of the points that I think we agreed
16 on.

17 A Very good.

18 Q You don't believe that the proposed conversion is going to
19 substantially lessen competition or tend to create a
20 monopoly in the healthcare business; is that correct?

21 A I agree.

22 Q You agree it will not?

23 A I agree it will not.

24 Q Okay. And you also agree that even assuming that Premera
25 has market power in Eastern Washington, it can't exercise it

1 because it is constrained by its practices and the
2 regulation of the Insurance Commissioner?

3 A Yes, I agree.

4 Q You agree that Western Washington is completely competitive?

5 A I'm not sure completely competitive. Highly --

6 Q Is highly competitive?

7 A Yes.

8 Q And as I understand your testimony now, different from your
9 report, you - you base your analysis of Eastern Washington
10 only on the 14-county area rather than the full 20-county
11 area --

12 MR. ELLIS: I'll object to the question. I'm sorry.
13 Go ahead.

14 Q (BY MR. TAUSEND) -- the 14-county area being where Regence
15 does not have the Blue Shield?

16 MR. ELLIS: I will object on the grounds that the
17 question is argumentative and assumes facts not in evidence.

18 A Yeah. I --

19 JUDGE FINKLE: I need to rule, but overruled. If
20 you understand the question, you can answer.

21 A I'm not sure. I would have to look at my report, but the
22 answer is yes, I base my current analysis on the counties
23 where Premera does not have the Blue Shield brand name.

24 I don't know whether that's the same as what you asked
25 me or not.

1 Q (BY MR. TAUSEND) So what you are saying now is that - that
2 the only area where you have concern about market dominance
3 is the 14-county area?

4 A If you look at the market shares and the very small counties
5 in Southeast Washington, Premera's market share is high.
6 That is where the Idaho entity has the Blue Shield. But I'm
7 not willing to say that I have concluded they even have
8 dominance there because we are talking about such a small
9 number of people. So, yes, I think I will restrict my
10 analysis and conclusions about dominance to the 14-county
11 area.

12 Q And on the selling side in that 14-county area, any such
13 exercise of market power is constrained by state regulation?

14 A And - and Premera's policies.

15 Q And policies being statewide community rate setting?

16 A Yes. And there are other constraints from the OIC in the
17 individual market, but the - the Premera policy dominates
18 those, so there could be constraints beyond that.

19 Q There could be regulatory constraints beyond the ones you
20 mentioned?

21 A Yes.

22 Q What --

23 A I understand that Premera would - would need to justify
24 the - if, for example, they attempted to raise rates in that
25 14-county area for individual policies, deviating from their

1 current statewide rates, that that could elicit a response
2 from the OIC requiring them to justify that as being based
3 in some extent on cost.

4 Q Now, looking at your testimony about market power - are you
5 okay?

6 A Yes.

7 Q -- market power they have in the 14-county area in Eastern
8 Washington on the provider side --

9 A Yes.

10 Q -- on the buying side, you testified on deposition, did you
11 not, that that market power had been fully utilized?

12 A Yes. I think there is evidence indicating it has been fully
13 utilized.

14 Q And is that your opinion, that it has been fully utilized?

15 A Yes.

16 Q And what is the antitrust significance of that conclusion?

17 A I'm not sure how to answer that. There is a significance
18 with respect to this issue of conversion.

19 Q If it has been fully utilized, then the conversion can't
20 change whether they can utilize it more, it has been fully
21 utilized; is that not correct?

22 A That's what I had in mind, yes.

23 Q Okay. In other words, the conversion will have no effect on
24 their exercise of market power on the buying side in Eastern
25 Washington?

1 A At least I - I see no evidence that it will because I see
2 evidence of physician groups and hospital groups being at
3 the edge in the bargaining. By that, I mean that, you know,
4 at the point where they are strongly resisting any further
5 declines in their reimbursements rates which economically
6 says you have exploited what power you had.

7 Q Anywhere you looked, Dr. Leffler, did you find any evidence
8 of supracompetitive prices charged by Premera?

9 A No. I mean, as I say, I - we could take them individually -
10 individual small and group and large, but in every case I
11 found either regulatory constraint, a procedural constraint
12 or a market constraint.

13 Q And did you find any evidence of supracompetitive or above
14 normal margin - profit margins?

15 A No.

16 Q Now, you said you can take them by group or overall?

17 A Okay.

18 Q Are you backing away from what - from your market
19 identification of separate markets in separate lines of
20 business?

21 A No. I mean, it's a subtle issue, but no. I don't think
22 it's an issue of any significance.

23 Q In terms of measuring market share?

24 A Right. Whether I measured market share in individual and
25 small group or measured market share individually for

1 individual and for small group, I get the same answer.

2 Q And the only place that market share concerns you is in the
3 14-county area; is that correct?

4 A It is the only place in which I see a dominant market share
5 leading to further analysis.

6 Q Okay. We will get to that.

7 And any effort or intention desired to lower
8 reimbursement rates in Eastern Washington by Premera in the
9 14-county area would be constrained, is that not correct,
10 can't do it?

11 A By market - I mean, if you have already done it, it would be
12 saying a monopolist has already exploited the market and
13 they are at the monopoly price.

14 Q Okay.

15 A It wouldn't be profitable to do it, or desirable to Premera.

16 Q I just want to review with you briefly your communications
17 with PricewaterhouseCoopers and their team.

18 A Okay. Yes.

19 Q After you completed your preliminary report, you exchanged
20 reports with them?

21 A Yes.

22 Q So they got a copy of your preliminary report?

23 A Yes.

24 Q And after that, you had contact with them on a telephone
25 conference?

1 A Yes.

2 Q And that included Ms. Maerki and Mr. Staehlin and Sandi
3 Hunt?

4 A I believe. Certainly Mr. Staehlin is who I recall vividly,
5 and other people.

6 Q And they raised questions with you and you raised questions
7 with them about --

8 A Yes.

9 Q -- what Premera could do?

10 A Yes.

11 Q And on the basis of that discussion, you then made a change
12 in your actual antitrust report from what had been in your
13 preliminary report?

14 A Yes.

15 Q And is it a fact that you didn't ask and don't know whether
16 or not without - what I call the Staehlin hypothetical
17 theory could work? You have no way to know if it could work
18 or not?

19 MS. HAMBURGER: Objection. Argumentative.

20 JUDGE FINKLE: Overruled on that basis. I'm not
21 sure that the Commissioner and I understand the premise,
22 though, that Staehlin hypothetical.

23 MR. TAUSEND: No, and that will come in later.

24 JUDGE FINKLE: Yeah. I --

25 MR. TAUSEND: But I just want to lay the basis for

1 that now. Mr. Staehlin was originally going to testify
2 before this witness, but we moved out of order.

3 JUDGE FINKLE: Okay.

4 Q (BY MR. TAUSEND) I just want to establish that you don't
5 support or not support the Staehlin theory?

6 A I have no opinion on the Staehlin theory. I - I simply -
7 and my report, I hope, reflects it, that I assumed that a
8 proposal he will offer could be done and if - and I hadn't
9 considered that in my initial report.

10 So based on that presumption, I edited the language to
11 say if you can do this, then my earlier conclusion is not
12 quite right.

13 Q Based on the theoretical possibility, you don't know if it
14 exists or not, right?

15 A I don't know whether it could be implemented. That is, I
16 don't know that, in fact, Premera could do what is being
17 proposed.

18 Q And you don't know whether or not it would be prevented by
19 state regulation?

20 A I certainly don't know that. I don't know, first of all,
21 whether it could be physically done. Secondly, I don't know
22 whether OIC regulations would constrain it.

23 Q Is it your understanding that PwC's proposal is based on
24 anything currently being done by Premera?

25 A My understanding is that this is a - this would represent a

1 change in the way - in the way Premera is currently
2 operating.

3 Q Okay. So the answer is no, right, it is not being currently
4 done by Premera?

5 A That's my understanding, yes.

6 Q All right. And in your supplemental report, you added a
7 comment - a footnote, I think, that in light of the
8 assurances - the economic assurances that Premera agreed to,
9 that - I think the word you used was "mitigated" your
10 concerns, the possibility of even if this could be done, it
11 wouldn't be done?

12 A As I understand the assurances, it would remove this
13 possibility.

14 I'm only smiling because it is a mystery to everybody
15 else what this possibility is. But it would remove this
16 possibility.

17 Q Okay.

18 MR. TAUSEND: I hope you bear with us. I need to do
19 this without - I don't want to go into the details of that
20 because that will be done by another witness. I just want
21 to distance - make sure of this witness's testimony on the
22 impact of his testimony with respect to PwC's is clear.

23 Q (BY MR. TAUSEND) Now, you testified as to what you called
24 "impediments to entry"?

25 A Yes.

1 Q Do you use the term "impediments to entry" as synonymous for
2 "barriers to entry"?

3 A Yeah, "barriers to entry" would be the term of art.
4 "Impediments" would be the term everyone would understand,
5 but, yes, I'm using them synonymously.

6 Q So the antitrust term of art is "barriers to entry"?

7 A Yes.

8 Q And would you agree if there are no barriers to entry
9 regardless of market share or market definition, then there
10 aren't any competitive problems?

11 A I would agree. I would strongly agree, yes.

12 Q And if there are low barriers, the same thing?

13 A Well, if there are low barriers to entry, then the problem
14 is limited.

15 Q I want to look at the testimony you gave with respect to the
16 experience of Asuris in Spokane.

17 A All right.

18 Q Okay. And you agreed that - you testified that the Spokane
19 metropolitan statistical area is a relevant market?

20 A Yes.

21 Q And I asked you on deposition if the figures were to show
22 that Asuris had significant growth in, say, a line of
23 business - the small group business in Spokane between 2001
24 and 2002 and 2003, that would affect your conclusion with
25 respect to the distance of barriers to entry, do you recall

1 that?

2 A Well, barriers to expansion, but it would affect my --

3 Q Same thing.

4 A I mean - they are not the same thing, but --

5 Q Excuse me.

6 A -- they both affect the interpretation of dominant market
7 share.

8 Q In other words, if there was significant expansion by
9 Asuris, then you would conclude - you would have to alter
10 your conclusions about whether or not Premera had dominant
11 market share or market power - market power in that market?

12 A If Asuris and the other providers who are in the market, and
13 are currently quite small, could easily, rapidly at low cost
14 expand, then that obviously is a constraint on Premera.

15 Now, it is subtle. Maybe they are doing it because
16 Premera raises the price, but I don't know that. But yes,
17 in and of itself it might be a fact suggesting relatively
18 low costs of expansion.

19 Q And if they are expanding because Premera has raised the
20 price, then that shows that the competitive process is
21 working, doesn't it?

22 A Well, it limits Premera's ability to exploit their market
23 power.

24 Q It is a constraint?

25 A It is a constraint, yes.

1 Q And it also raises a question as to whether they have market
2 power, doesn't it?

3 A It would - yes, it could raise the question. It doesn't
4 answer the question, but it says that more needs to be
5 looked into.

6 Q All right. Dr. Leffler, what I have handed you - I have
7 prepared this for easy reading purposes - is a replication
8 of the small group enrollment for Premera and Asuris
9 head-to-head in Spokane County. The source is from Form B.

10 MR. TAUSEND: And we have that here, Your Honor, and
11 I can offer the Form Bs for Premera and the Asuris for 2001,
12 2002 and 2003. And we - we would offer them, but they are
13 too difficult to read and so I'm using this and making it
14 subject to check.

15 And I actually am supposed to have by now certified
16 copies so that they can be admissible on that basis as
17 something that you can take official notice of.

18 JUDGE FINKLE: Well, go ahead and ask your question
19 and we will hear if there is an objection.

20 MR. ELLIS: If I may, Your Honor, I just have a
21 question really concerning the document. In the lower
22 left-hand corner it says that it is privileged and
23 confidential, but at the same time the source is Form B
24 data, which, as I understand it, is public information. And
25 so I would think there would be a question as to how this

1 documents needs be handled.

2 MR. TAUSEND: It is not privileged. It is Form B
3 data. That was put on as a routine, but you can cross it
4 right off and I'm going to do that.

5 MS. HAMBURGER: Your Honor, I also have a question
6 where it says, "Asuris share," and is that data also from
7 the Form B, which I would assume is raw numbers? So that I
8 think there may be analytical data that is not complete
9 here.

10 JUDGE FINKLE: Maybe. But let's hear a question and
11 then I will listen to an objection.

12 MR. TAUSEND: Okay.

13 Q (BY MR. TAUSEND) And, Dr. Leffler --

14 A Mm-hmm.

15 Q -- you testified on direct that Regence was effective in the
16 six-county area - in the four-county area, Walla Walla and
17 so forth, with 30 percent in areas where it has the Blue
18 mark; is that correct?

19 A Yes.

20 Q And Asuris is the Regence affiliate which does not have the
21 Blue mark?

22 A Yes.

23 Q And what we have taken - you also said that the other
24 competitors in the Spokane area had small amounts; is that
25 correct?

1 A Yes.

2 Q Okay. So looking at just head-to-head Premera versus
3 Asuris, you see that in 2001, Premera had 27,859 small group
4 enrollment?

5 A Yes.

6 Q And in 2002, it had 24,354?

7 A Yes.

8 Q And in 2003, it shrank to 21,712?

9 A I see that, yes.

10 Q At the same time, Asuris in 2001 had 1,901?

11 A Yes.

12 Q And in 2002, it went up to 8,509?

13 A Yes.

14 Q In 2003, it has got up to 11,399?

15 A Yes.

16 Q And this is in the area of where they don't have a Blue
17 mark; correct?

18 A Yes, it is. Spokane does not have the Blue mark.

19 Q And the figures that I have, then, below are simply a
20 computation, which you can check, of Asuris's share in 2001
21 head-to-head just with Premera is 6.4 percent; in 2002, 25.9
22 percent, and for 2003 in the small group, it's 34-and-a-half
23 percent, 34.4 percent.

24 A Yes. I mean, I'm assuming you have done the numbers right.
25 And there is issues with 2002, but putting all those aside,

1 yes, I'm willing to react to these numbers.

2 Q Okay. Let me just ask you with respect to 2002, the issue
3 you had raised in the footnote in your testimony with
4 respect to 2002 was that the Premera data only you thought
5 was not accurate; isn't that correct?

6 A It was more than the Premera data. The Premera data was
7 data I could check --

8 Q Yes.

9 A -- that I could verify, but I don't have - I don't have any
10 reason to believe these aren't correct numbers.

11 Q Okay. Okay.

12 A And I have no reason to believe that in 2003 there were
13 problems, so the fact that 2002 is in between them suggests
14 that there probably is not such a problem.

15 Q And I should also point out to you that the numbers I have
16 here for 2002 with respect to Premera are based on the
17 revised data filed at the end of last year.

18 A Very good.

19 Q Okay. On the basis of these figures, do you conclude, then,
20 that Asuris now has a significant part of the - of the small
21 group enrollment market in Spokane?

22 A Yes, this would probably - I think the other insurers are
23 probably five, six, percent so they probably have 30 percent
24 of the Spokane small group market in 2003.

25 Q And that's significant, right?

1 A That is significant.

2 Q And they have done it even without the Blue mark?

3 A They have.

4 Q Doesn't it also demonstrate to you that there is switching?

5 A If you mean by that that - I think the only - the only thing
6 that could possibly explain this data is some small group
7 employers used to be getting their insurance through Premera
8 and they are now getting it through Asuris.

9 Q So there has been switching?

10 A If that's what you meant by switching.

11 Q That's what I mean.

12 A Yes. Yes. There is not enough other people to have
13 anything else explain this.

14 Q Okay. So that would get you to - you conclude, would it
15 not, consistent with your testimony that there are no
16 significant barriers to entry at least as far as the Spokane
17 market is concerned as far as Asuris and Premera is
18 concerned?

19 A Well, it certainly suggests that Asuris has been able to in
20 Spokane expand substantially over a two-year period.

21 MR. TAUSEND: This is P-32. You may already have
22 it. Do you?

23 JUDGE FINKLE: We probably do, but if you have got
24 extra copies, that's helpful. Thanks.

25 Q (BY MR. TAUSEND) Now, you were in - in court this morning

1 when Ms. Hunt testified?

2 A I was, yes.

3 Q And do you recall her testimony with respect to Table 3-1?

4 A Yes.

5 Q And, at that point, she - she identified the PPO enrollment
6 covered lives for Aetna?

7 A She did, yes.

8 Q And she identified the numbered policies - the number of
9 covered lives in Eastern Washington, through the Tri-Cities
10 area, Spokane and Yakima?

11 A Yes.

12 Q And you had indicated in your responsive testimony that
13 there were only 23 covered lives by Aetna?

14 A I don't recall the number, but very few.

15 Q And, in fact, on the basis of this, in Eastern Washington
16 there were over 13,000; is that not correct?

17 A Well, you are comparing two different things. You are
18 comparing - I won't say apples and oranges. I would say a
19 car and a shoe.

20 Q Because this includes self-insured?

21 A Yes.

22 Q Okay. But they are a factor in the market, are they not?

23 A Well, in the large group market they are certainly a factor.
24 No doubt about it.

25 Q Okay.

1 A But my - my numbers were with respect to - not including
2 that. It was including the small group individual market.

3 Q Now, if - if you look at this, isn't it true that in order
4 to be able to have that presence in the market, Aetna has to
5 have a claims procedure set up?

6 A Yes.

7 Q And it has to have providers?

8 A It or somebody it contracts with.

9 Q Or it could rent providers?

10 A Yes.

11 Q And it has to have a network for Eastern and Western
12 Washington, does it not?

13 A By "network," you mean providers?

14 Q Provider networks.

15 A It has to have providers in the area it is offering its
16 administrative services for self-insured purposes, yes.

17 Q And it would have to have a member services department?

18 A Presumably so, yes.

19 Q And it would have to have established relationships with
20 brokers, wouldn't - wouldn't it?

21 A At least particular brokers who deal in this segment of the
22 market, yes.

23 Q So isn't it fair to say that on this basis, Aetna has all
24 the fixed assets in place it would need to offer small group
25 or add small group to the products they offer - the lines of

1 business they offer?

2 A It certainly is in a position that is very different than a
3 noncommercial insurer, an insurer who is not already
4 operating within the state. And it would clearly find that
5 to be less costly than those other entities.

6 Q On that basis, would they be potential entrants?

7 A They are - I don't think they are potential entrants. They
8 are actual entrants. They are, in fact, in those markets,
9 they are just not successful, that is, they report in the
10 Form B filings that they do offer small group plans, they
11 just don't sell very many of them.

12 Q At this point?

13 A At this point, or for a number of years, they haven't. But,
14 yes, they are in a very different position than they Molina
15 trying to do that or I have heard Humana discussed.

16 Q Okay. Let me just stick with Aetna, please.

17 A Okay.

18 Q Are there areas of the country where commercial insurers
19 are, in fact, paid less than Medicare?

20 A Are there areas of the - I don't understand the --

21 Q In some part of the country are there lower reimbursement
22 rates --

23 A Okay.

24 Q -- than Medicare plans?

25 A Are you asking me do commercial insurers ever pay

1 reimbursement rates that are less than Medicare?

2 Q That's correct.

3 MR. ELLIS: I will object to the questions unless
4 the question is related to the State of Washington and some
5 relevance to this proceeding is established.

6 JUDGE FINKLE: Overruled.

7 A I don't know.

8 Q (BY MR. TAUSEND) The reason I ask you is that I saw an
9 article in the Providence Journal of this very day that
10 indicated that Blue Cross okays a boost in its pay for
11 providers. Medicare, in the article, for an office visit is
12 \$53.07, Blue Cross/Blue Shield of Rhode Island is \$50 and
13 United is \$32.05.

14 Now, if you will accept my reading of that article for
15 purposes of this hypothetical, doesn't that lead you to
16 believe that if that's the case, then you have to include
17 Medicare and should include administrative service contracts
18 business in your analysis - in your analysis of market power
19 with respect to the purchase of provider services?

20 A Well, I can't speak to Rhode Island. I suspect that either
21 the data is wrong - I can't believe that a private insurer
22 would have providers that would - would have providers
23 accepting their patients if they are paying almost half of
24 Medicare.

25 But independent of that, it doesn't have any

1 implications for the analysis that I have done in Eastern
2 Washington where that's not true.

3 Q And that's because, at this point, they are not paying less;
4 is that correct?

5 A The point is simply that Premera - yes, Premera controls a
6 substantial segment of the population that providers see and
7 those patients are reimbursed at rates closer to the normal
8 fees of the physicians than the reimbursements under the
9 government-subsidized plan.

10 Q In rural Washington - in rural Eastern Washington where
11 there are few physicians, Premera has to have the physicians
12 there in its network in order to provide the services and
13 coverage its want to to its member, does it not?

14 A Yes. Premera runs into what we call a bilateral monopoly
15 problem in certain areas in the State of Washington. In
16 fact, that's likely true in the Wenatchee area for very
17 different reasons.

18 Q And when you say a bilateral monopoly situation, that means
19 that the doctors also have a monopoly?

20 A If you are the only orthopedist in 400 miles - that's way
21 too long - a hundred miles, yes, they are in a very
22 different bargaining position with Premera than if you were
23 an orthopedist in Spokane.

24 Q And you understand that Premera operates in all the counties
25 of Washington?

1 A Yes.

2 Q And considers that an important strength of their identity?

3 A I don't know that, but --

4 Q There has been testimony to that?

5 A Okay.

6 Q Do you have any reason believe that they would withdraw from
7 any county?

8 A I don't have an opinion either way.

9 Q Okay. I want to refer to Exhibit S-81. That's the
10 exchange - do you have it?

11 A I have it.

12 MR. TAUSEND: Do you have it?

13 JUDGE FINKLE: We will in a second.

14 Oh, that's . . .

15 Thank you. We already had it. Thanks.

16 Q (BY MR. TAUSEND) Now, you testified that you believe
17 Premera pays physicians less in Eastern Washington than in
18 Western Washington; correct?

19 A No, I don't recall testifying to that. I testified that
20 their discounts were larger in Eastern Washington than in
21 Western Washington. I think it is true, but I don't think I
22 testified to it.

23 Q Okay. Now, we will deal with that.

24 Exhibit 81 - S-81 that you offered is an exchange
25 between you and Premera giving an interpretation and saying

1 - at the end the response, "This interpretation is correct."

2 A Yes.

3 Q Do you now understand that Premera disagrees with your
4 conclusion?

5 A No. I haven't heard all the testimony in this proceeding.
6 I had a reaction to the initial filing of my report in which
7 Premera responded that I should be looking at Dimensions.
8 And I looked at Dimensions and included it in my final
9 report, but there was no discussion of something wrong.

10 Q Let me - let me call your attention to the testimony of
11 Ms. Halvorson, who testified the day before yesterday. You
12 know Ms. Halvorson, the actuarial vice-president?

13 A I know the name, I have never met her.

14 Q Have you read her testimony?

15 A No.

16 Q Let me read this to you.

17 Question: "Dr. Leffler states that the geographic areas
18 factors by network reflect the provider reimbursement level
19 differences by area. Do you agree with this comment?"

20 Answer: "No, I do not. The network geographic factors
21 reflect the estimated relative cost of care that is expected
22 to be provided to members who live in each of the areas not
23 just the differences in provider reimbursement levels.

24 "Premera's geographic areas factors are based on
25 expected differences in unit costs for hospitals and

1 professional services within a defined area, efficiencies of
2 the various networks by area and then adjusted for the
3 pattern of where policyholders living within the area are
4 expected to receive care."

5 And she concludes, "The differences in provider
6 reimbursement levels by area are only one of the three
7 factors used to develop the geographic factors."

8 Now, does that change your understanding of Premera's
9 practices in --

10 A I don't think it has anything to do with what I said. If I
11 were in your position, I would object that it is
12 nonresponsive, that is it is talking about something else.

13 Q With respect to Exhibit S-115, and that's the one where the
14 bottom half is --

15 A Yeah. Secret.

16 Q It is confidential.

17 A Yes.

18 Q As a benchmark, did you examine the differences between
19 Premera's rates and Regence's rates in Western Washington,
20 which you say is competitive?

21 A No.

22 Q Did you examine what the difference would be between Eastern
23 Washington and Western Washington outside of King County?

24 A No.

25 Q Okay. So you - you don't know, then, and have no opinion as

1 to whether Premera's rates relative to Regence's are about
2 the same, do you?

3 A In other words, you are asking me did I examine data that
4 would indicate the relationship between the average
5 reimbursement Regence has in areas other than Spokane?

6 Q Yes.

7 A I did not. I did not have any data on that.

8 Q Okay. So it could be the same difference in Western
9 Washington, which is competitive, that it is in Eastern
10 Washington?

11 A I wouldn't expect that to be true, but it could be, yes.

12 Q And you don't know?

13 A I don't know.

14 Q And in your evaluation, did you weight the figures in terms
15 of utilization?

16 A No. I think, as I testified, these are simple averages.

17 Q And depending on the amount of utilization, weighting it
18 could make a difference, could it not?

19 I just want a "yes" or "no" answer to that question.

20 A It could.

21 Q Okay. Now, you and Dr. McCarthy disagree on the question of
22 defining the relevant market, do you not?

23 A Apparently we do.

24 Q Okay. I read to you on your deposition administrative text
25 called "Carlton and Perloff." Do you recall that?

1 A Yes.

2 Q And you indicated that Carlton and Perloff was the best
3 text?

4 A The text in that area, which is called, "Industrial
5 Organization."

6 Q And Carlton and Perloff says that "The proper definition of
7 product dimension of the product market should include all
8 those products that are close demand or supply substitutes."

9 Do you recall that?

10 A I'm very familiar with the text and I think in the same - if
11 you look at the text on the opposite page of that quote,
12 there they have the Merger Guidelines.

13 Q Okay. So they consider both the Merger Guidelines and
14 market definition being - including supply substitution?

15 A They do in their text, yes.

16 Q Okay. Now, market share was your starting point for
17 analysis of market power in this case and market dominance,
18 was it not?

19 A Yes, it was seen whether to go forward, if you will.

20 Q If you had a market share - if Premera had a market share of
21 50 percent or less, that would indicate no market power?

22 A I would - that would be presuming no market power, yes.

23 Q And that would end your analysis, wouldn't it?

24 A Yes.

25 Q So market definition is significant in taking you to the

1 next step as to whether or not there is market power at all,
2 isn't it?

3 A It is significant in kind of a negative sense. It just
4 makes life easier in that you don't have to consider a
5 number of questions that otherwise you would consider.

6 Q And if you had a different market definition - relevant
7 market definition, then you wouldn't in your analysis have
8 gone to the next step at all if that market definition
9 showed a relevant market of less than 50 - 50 percent or
10 less; is that not correct?

11 A Well, I'm assuming I had a correct market definition. Yes,
12 if I correctly defined the market and found the market less
13 than 50 percent, I would not have examined impediments to
14 entry.

15 Q And in terms of market definition, you reject the concept of
16 supply substitution, do you not?

17 A I certainly reject that in calculating market share one can
18 take account of that level of supply substitution. It is a
19 totally undefined concept.

20 Q Let me repeat my question and make sure I have you clear on
21 that.

22 In defining market share, which is the starting point,
23 you do not think it appropriate to include supply
24 substitution in your identification of the relevant market;
25 is that correct?

1 "Yes" or "no," please, doctor.

2 A That's correct.

3 Q Okay. And that's what you did here, you rejected supply
4 substitution in defining market share; is that correct?

5 A Two different questions.

6 Q In defining market share --

7 A Defining market share is not what you asked me before, that
8 is the problem.

9 Q In defining - you are correct. In defining the relevant
10 market, you did not consider supply substitution?

11 A Yes.

12 Q Okay. And by supply substitution, we understand the ability
13 of suppliers to change what it is they produce or sell in
14 response to changes in price to enter a market with a new -
15 with a product that they haven't offered in that product -
16 in that market before?

17 A Yes. It is a fancy term for entry.

18 Q Okay.

19 A It means entry.

20 Q Okay. Now, did you testify as an expert by affidavit in
21 Rebel Oil versus Atlantic Ridgefield Company?

22 A I did.

23 Q And that was a case in Nevada in the early 1990s?

24 A Yes.

25 Q And in that case you defined the relevant market on behalf

1 of the plaintiffs as the market for - it was a
2 monopolization of self-service cash only gasoline sales; is
3 that not correct?

4 A Self-service I'm not sure, but the cash part, yes, but
5 self-service, I don't think it matters.

6 Q And in that case you defined the market in terms of the
7 demand considerations alone, did you not?

8 A Yes.

9 Q And the Court of Appeals in that case held it was erroneous
10 to define the market on the basis of the demand
11 considerations alone and ruled that a reasonable market
12 definition must also be based on supply consideration,
13 supply elasticity; is that not correct?

14 A I wouldn't phrase it that way, but the appellate court
15 reached a decision that included a broader set of products.

16 Q Based on supply substitution, did it not?

17 A Yes. I mean, it is subtle language and one could interpret
18 it in different ways. But, yes, they do talk about the
19 possibility of "B" branding pumps, if you will.

20 Q And it related to market definition?

21 A It did.

22 Q So it is fair to say that your opinion was rejected by the
23 9th Circuit in terms of market definition?

24 A The 9th Circuit proposed a broader market definition. Yes.
25 I certainly disagreed with them and think they

1 misinterpreted the facts, but that happens.

2 Q But it's the law in the 9th Circuit?

3 A I can't speak to that.

4 Q Okay.

5 MR. TAUSEND: I will offer Exhibit P-178, which is
6 Carlton and Perloff, which was previously the excerpt as the
7 text I read from.

8 MR. ELLIS: We will object to the introduction of
9 this document, Your Honor. As Dr. Leffler testified, the
10 same section I believe of this book refers to and analyzes
11 the Merger Guidelines and I don't believe that this segment
12 that is being offered - this fragment of the text covers
13 that portion.

14 JUDGE FINKLE: Was the text itself available,
15 Mr. Tausend? Do you have the - the text that this is
16 excerpted from?

17 MR. TAUSEND: I don't have the full text, although
18 we - we did mark it and so I can offer that. I will offer
19 that after lunch.

20 MR. ELLIS: And we would have no objection so long
21 as the exhibit includes all of the portions that have been
22 discussed during Dr. Leffler's testimony.

23 JUDGE FINKLE: Admitted with that understanding.

24 MR. TAUSEND: Okay. That's all I have, Dr. Leffler.

25 THE WITNESS: Thank you.

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CROSS-EXAMINATION

BY MS. HAMBURGER:

Q Dr. Leffler, in your - in your supplemental report, you said
that the economic assurances would mitigate the likelihood
of it exploiting its market power; is that correct?

A Yes.

Q It doesn't remove that possibility?

A That's correct.

Q And it only addresses it for the time period that the
assurances are in place; is that correct?

A That's my understanding, yes.

MS. HAMBURGER: Thank you.

REDIRECT EXAMINATION

BY MR. ELLIS:

Q Dr. Leffler, going back to Mr. Tausend's questions about the Rebel Oil case, could you briefly provide the Commissioner with a little more detail on what the issue was concerning the proper definition of the product market?

A I will try. It was a predatory pricing case and it concerned the issue of whether or not the providers of full-service gasoline would respond to the alleged predator by rapidly rebranding into self-service gas.

And I had offered reasons why I felt that they would be constrained to do that and, therefore, limited my analysis to the self-service segment of the marketplace.

Q And do you recall whether the 9th Circuit in its decision was impressed that it would be very easy for a full-service station to simply remove the full-service sign and compete in the self-service segment?

A Yes. They are what we call economically call an uncommitted entry. That is someone who is really there and you are now talking about - it would be like if - I had a long discussion with Mr. Tausend in my deposition about certain size soups. So it is a situation in which the hurdle of facing the supply problems is not there because you have a ready way to assess market share.

1 While I disagree with what the court did, nonetheless
2 you had a ready way to assess market share because they are
3 currently selling gasoline. So we simply looked at the
4 market for the sale of gasoline.

5 That's, in a sense, extremely different than a case of
6 trying to take into account supply responses from people who
7 aren't in the market. There is no way to calculate market
8 share. And that's the way - the reason why I approach the
9 problem the way I do. First define market share; if you
10 can't define it, you can't go on.

11 And if you say to me, "I'm going to define the market
12 share and I'm going to include demand, how do I do it? What
13 value do I give them? Am I to include Molina," I can't
14 count their insurance in the Basic Health options. That's
15 irrelevant.

16 So that's the problem, that you don't know how to take
17 account of them. You can't get to the next step. You can't
18 calculate market share. The Rebel Oil, case you didn't face
19 that problem, so it is a very different situation.

20 MR. HAMJE: I have no further questions.

21 MR. TAUSEND: Just one.

22

23

24

25

RECROSS-EXAMINATION

BY MR. TAUSEND:

Q Dr. Leffler, in answer to Ms. Hamburger's suggestion -
question, you said in your footnote that it would - that the
assurance would mitigate the theoretical possibility posed
by Mr. Staehlin; is that correct?

A Yes.

Q And I think in your testimony you actually said it would
remove it.

A When I used "mitigate," I meant it was limited in time.

Q Other than that, it's - it is not a factor at all?

A I understand that during the period it is in place, if it is
effectively enforced, it would remove it in that period. So
it mitigated in a large sense, but removed it in a temporal
sense.

Q And you have no reason to suspect that it would be
effectively enforced?

A I have met some people at the OIC and I think they are quite
competent, so I --

Q I agree.

MR. TAUSEND: That's all.

JUDGE FINKLE: Any follow-up?

MR. HAMJE: Nothing further.

EXAMINATION

BY COMMISSIONER KREIDLER:

Q Dr. Leffler, I was trying to - to understand, perhaps, some aspects of the information that has been present and I was a little bit uncertain as to pricing that would take place, for example, within the individual and small group market relative to the costs of that insurance product in those two areas.

If, in fact, when - if the insurer is able to reimburse providers as - at a lower rate because of other factors, wouldn't that mean that they were in a position where they would be either able to charge comparable rates overall as the rest of the market and therefore - therefore have higher earning - higher profit net margins?

A I - I believe not. I think, in fact, the way your agency administers it, that effectively to the extent that Premera gets better rates, they either have to pass them on unless they are assumed in other costs.

Q Wouldn't that enhance your market share, though, by virtue of the fact that if you were reimbursing providers less and you had to pass it on, wouldn't it mean that your product was going to be lower than the market?

A That or your competitors are going to have difficulty making reasonable margins themselves. Yes, it gives you an

1 advantage in the marketplace.

2 Q In - in the 14 counties - I think it was 14 counties that
3 you identify where the Blues mark was exclusively held by
4 Premera in Eastern Washington, does that mean that if they
5 are successful in negotiating lower provider rates as a part
6 of their health insurance plan that it is going to be
7 difficult for a competitor to come into that market and be
8 successful presumably?

9 A Yes. To the extent that they pass on those costs - those
10 lower costs and do not have any offset in higher costs, yes.

11 Q Very good.

12 COMMISSIONER KREIDLER: Thank you very much. No
13 further question.

14 MR. TAUSEND: Just one question.

15 JUDGE FINKLE: I'm sorry, but let me make sure
16 that --

17 MR. ELLIS: Nothing here.

18 MR. TAUSEND: Just one question.

19

20 RECROSS-EXAMINATION

21

22 BY MR. TAUSEND:

23 Q Following up on that question, would the success and
24 presence of Regence Asuris in Spokane be an offset to the
25 concerns that the Commissioner has expressed?

1 A Yes. I only pause because I can't do it now, but it would -
2 I would like to look into the reason that Asuris has been
3 successful. The numbers you have showed me certainly
4 indicate substantial success recently on the part of Asuris.

5 And if that's just because they are able to set good
6 rates that they can continue setting, then yes, it would -
7 it would suggest that regardless of what is going on with
8 Premera's reimbursement rates and operations, that they have
9 an effective competitor out there that will constrain them.

10 JUDGE FINKLE: Okay. We will see you at 1:30.

11
12 (Lunch recess.)

13
14 JUDGE FINKLE: Ready to proceed when you are.

15 MR. TAUSEND: I got to get this right now.

16 JUDGE FINKLE: Okay.

17 MR. TAUSEND: Your Honor, Mr. Ellis and I have one
18 housekeeping matter and it is related to the exhibit which
19 was Carlton and Perloff one. And that was the one I offered
20 the excerpt and he said if we had the entire Chapter 19,
21 then he doesn't have an objection. We are getting the
22 entire Chapter 19. I want to show him the chapter and then
23 he and I can stipulate to its admission.

24 Is that satisfactory?

25 JUDGE FINKLE: Sounds good. Just go ahead and

1 substitute when you are ready.

2 MR. HAMJE: Your Honor, my understanding is that
3 Mr. Coopersmith has asked on behalf of his client WSMA, to
4 take one of their witnesses out of order today and both -
5 and so far as the OIC staff is concerned, we have no
6 objection. I understand neither does Premera.

7 MS. EMERSON: No objection.

8 MR. COOPERSMITH: Thank you to the OIC for
9 accommodating us.

10 JUDGE FINKLE: And Premera as well.

11 MR. COOPERSMITH: And Premera as well. Thank you,
12 Your Honor.

13 At this time, we would like to call Dr. Jeff Collins to
14 the stand.

15

DR. JEFF COLLINS, having been first duly
16 sworn by the Judge,
 testified as follows:

17

18 JUDGE FINKLE: Please sit down.

19

20 DIRECT EXAMINATION

21

22 BY MR. COOPERSMITH:

23 Q Good afternoon. Could you state your name and tell us your
24 occupation for the record, please.

25 A I am Dr. Jeff Collins. I'm a general internist in Spokane,

1 Washington.

2 Q And where do you practice?

3 A I practice at a physicians clinic of Spokane.

4 Q And can you tell us briefly what an internist does?

5 A An internist is a physician who sees primarily adult and
6 adolescent patients. We do what is called primary care,
7 which is to say heart problems, lung problems, infection,
8 you know, stomach problems, those sorts of things.

9 Q And how long have you been taking care of kids and adults?

10 A I have been in practice since 1985.

11 Q And about how many patients do you see or have you seen over
12 that time?

13 A I see about 300 patients in a month. So over almost 20
14 years, that would be a lot. Many thousands. Many
15 thousands.

16 Q Okay. And you - that's a scientific term, "a lot."

17 Have you filed revised direct testimony in this case?

18 A I have.

19 Q And do you adopt that testimony?

20 A I do.

21 MR. COOPERSMITH: Your Honor, we now move to enter
22 Intervenors' Exhibit 101 into evidence.

23 MS. DeLEON: No objection.

24 MS. EMERSON: No objection.

25 JUDGE FINKLE: Admitted.

1 MS. EMERSON: Although, just for the record, I know
2 that counsel for the WSMA did at least initially offer or
3 include in your proposed exhibits the - the original version
4 of Dr. Collins' testimony. My understanding is it was
5 revised.

6 MR. COOPERSMITH: And that's been substituted
7 previously, yes.

8 MS. EMERSON: Okay. So Exhibit 101 is the revised?

9 MR. COOPERSMITH: That's correct.

10 MS. EMERSON: Thank you.

11 Q (BY MR. COOPERSMITH) Dr. Collins, have you been active in
12 any professional societies?

13 A Yes. I was on the board of the Spokane County Medical
14 Society for many years. And in 1994 I was the president of
15 the Spokane County Medical Society. Since that time, I've
16 the been on the board with WSMA, the Washington State
17 Medical Association. I am the current president of the
18 WSMA.

19 Q And can you tell us more about your practice? How many
20 physicians are in your clinic?

21 A Our group is about 20 general internists. We practice in
22 Spokane. We have three offices and we see - we all do
23 primary care medicine.

24 Q And how large does that make your clinic compared to other
25 clinics in Eastern Washington?

1 A Well, in Spokane, we are actually one of the larger clinics.
2 There is the Rockwood Clinic with about 105 doctors or so
3 and they are the largest clinic in the region. We are
4 probably the largest primary care clinic. And the vast
5 majority of the practices in Spokane are smaller practices.
6 Sixty percent of the doctors in Spokane practice in
7 five-doctor-or-less groups.

8 So in the last few years, there has been some
9 consolidation. There are a few larger specialty groups,
10 cardiology, cervical specialty, but for the most part, we
11 are one of the largest groups.

12 Q And what kind of insurance coverage does patients at your
13 clinic have?

14 A In our clinic about 50 percent of the patients have Medicare
15 or Medicaid. And - there is a small fracture who are
16 uninsured and the remainder have commercial insurance and
17 about half of those are insured by Premera.

18 Q And has that always been the case?

19 A In general, that's always been the case although over last
20 few years there has been a lot of - there has been some
21 changes in the portion in that several of the commercial
22 players have left the market in Eastern Washington. And
23 those would include companies like QualMed, Sisters of
24 Providence, PacifiCare. They are gone and have not been
25 replaced.

1 Q And so has the departure of those insurers affected your
2 clinic?

3 A It has. It has made - it has made Premera relatively more
4 dominant than it used to be, although it was always a big
5 player, and it has made fewer options for employers in the
6 community to obtain insurance for their employees and for
7 individuals as well to get insurance.

8 Q Can you tell us what carrier has the next biggest share of
9 your clinic's business?

10 A In our practice, the next biggest share would be PHCO, which
11 has five percent of our total charges.

12 Q So Premera has about five times greater share than the next
13 biggest carrier; is that right?

14 A That is --

15 MS. EMERSON: Objection. Leading.

16 JUDGE FINKLE: Well, I think it is arithmetic, so
17 overruled.

18 Q (BY MR. COOPERSMITH) Okay. Is that typical of your
19 colleagues in Eastern Washington?

20 A That is.

21 Q And can you tell us if you believe that Premera influences
22 the patient-physician relationship?

23 A Well, I think that - over time I think it does. And the way
24 that it does is that is we have - we have seen just
25 progressively increasing administrative burden and sort of

1 speed bumps in what we believe are necessary for our
2 patients.

3 So it has become more difficult to sort of advocate on
4 behalf of our patients and get what we believe is the
5 indicated medical care for them.

6 Q Do you have any examples regarding medical necessity and
7 where Premera might dispute the medical necessity of what
8 you are trying to do for your patients?

9 A Well, I have one fairly recent one that I was working on
10 just within the last week in that I have a patient that I
11 had been seeing for sometime who actually, for appropriate
12 indicated reasons, required testosterone injections. And,
13 actually, they had been approved at some point, but all of a
14 sudden they were not approved anymore. And so they were
15 denied.

16 And we had to go through this process to get them
17 approved, and ultimately we did. Ultimately we - we
18 initially got a letter back indicating it was not medically
19 necessary for a reason. And then after letters and sending
20 copies of chart notes and faxes back and forth, we actually
21 were able to get that approved. So it stretched out over a
22 period of several months, but we are able to get this
23 therapy approved.

24 The point is that not that we didn't get it approved.
25 We did. The point is the amount of time and energy it took

1 to get what was then indicated and appropriate therapy for
2 the patient.

3 And it sort of took up all this time that really we need
4 for other patients. I mean, there is only so many hours in
5 the day and what we are supposed to be doing is taking care
6 of patients and not sort of fighting the speed bumps.

7 Q And, in your experience, has Premera denied medically
8 necessary care?

9 A Well, I think - I think that they have and - are you asking
10 for an example?

11 Q Well, you can give an example, if you like.

12 A Just, again, because I'm in the position to be the
13 president, people sort of call and complain to me a lot.
14 And I had another example of that with a surgeon was telling
15 me he had applied - he had authorization for a procedure and
16 it was actually - the procedure was a surgical procedure
17 necessary because of a different procedure which had
18 happened before.

19 So even, then, Premera had authorized the first
20 procedure and they wouldn't authorize the second procedure.
21 And he was still fighting that as of a few days ago when I
22 talked to him.

23 Q Dr. Collins --

24 A I think that's an important 0 something clearly needs to be
25 done, but he has having to fight the same battle I had to

1 fight about the testosterone.

2 Q Dr. Collins, Premera states that it has become easier for
3 physicians to deal with the company. Do you agree?

4 A Well, that's not been my experience and that's not what I'm
5 hearing from my colleagues across the state when I'm
6 traveling around the state.

7 Q Can you tell us more about your ability to get answers from
8 Premera?

9 A Well, my experience, and, again, what I'm hearing
10 interestingly - I mean, it actually surprises me how much I
11 hear it - is we - you get a speed bump, like the
12 testosterone, for example. And you try to call provider
13 relations and what we get recurrently is "I" - "We don't
14 make that decision" and "That's X department" or "That must
15 be in a different computer system." And one person said,
16 "We have seven computer systems and they don't talk to each
17 other."

18 And I don't know if that's an excuse or if that's
19 reality. But those sorts of things keep coming. "We can't
20 make that decision." "Our computers won't talk to each
21 other."

22 You know, ultimately we usually get to the end of it and
23 we are able to get some resolution, but the point is it is
24 very difficult to do that. And I don't know how you
25 quantify that, but my experience is that it is not getting

1 easier.

2 Q And what about authorizations. Premera says it no longer
3 requires them. Is that your experience and that of your
4 colleagues?

5 A I - I'm an internist and so I don't do a lot of procedures
6 and so we are not in the position of actually getting a lot
7 of preauthorizations and that's more of surgical specialties
8 that do that. But certainly it is fewer than it used to be.

9 The need - the requirement for preauthorization is a lot
10 less with the newer products that Premera has. However,
11 there is still - from the standpoint - from the patient's
12 perspective, if you were going to be going through
13 something, you would kind of like to have some idea of
14 whether that is approved and authorized by your insurance
15 company.

16 And, again, another example I had recently is a patient
17 who, to be brief, needed an esophageal procedure, wasn't
18 sure if it was going to be covered. He said, you know,
19 "Before we go through all this, why don't we see if Premera
20 is going to cover it."

21 I said, "Okay. Fine."

22 And they have this little procedure that you can do - I
23 forgot what it is called - but, again, beneficiary
24 authorization or something like that. And you fill out the
25 form, you tell them what you have in mind and you send it

1 in. And we did that. And after a period of time, which was
2 something over a week, ultimately it was denied and we were
3 supposed to get a letter about that, but we didn't get it.
4 So I mean --

5 Q And you --

6 A They don't call it an authorization, but there is a process
7 you can do. And I don't know that it is any easier than
8 before.

9 Q Do you recall when that took place?

10 A March.

11 Q And has that been resolved yet?

12 A Well, maybe. In other words, I got a fax that said it was
13 denied, but it said there would be a letter coming, which I
14 haven't gotten.

15 Q And was the medical review done in that case by a physician
16 or by someone else?

17 A Well, the form was signed by an LPN.

18 Q And in your prefiled testimony, Dr. Collins, you stated that
19 Premera's decision about which drugs to cover seems to be
20 motivated more by financial consideration than what is in
21 the best interest of the patients.

22 What do you mean by that?

23 A Well, that - well, I - what I meant by that, that's the
24 nature of the formulary process. And there is nothing in
25 particular that is wrong with the formulary. I mean, a

1 formulary is a list of drugs. And in the case of an
2 insurance company, it is a list of drugs which are going to
3 be paid for. And so somebody has to make the decision which
4 drugs are going to be paid for and which ones aren't going
5 to be paid for.

6 And from the insurance company's, I think, perspective,
7 you choose the cheapest one. You choose the classic drugs.
8 You choose the cheapest drug. And that may work for many
9 patients. The problem is for the patient for whom that
10 doesn't work. And what happens to them? And that is then
11 they either have to pay for the drugs out-of-pocket.

12 And, as we all know from our personal experience, that
13 the cost of pharmaceuticals is very, very expensive and is
14 increasing all the time and it is very difficult for people
15 to afford or increasingly there is a thing called a tiered
16 pharmacy benefit where each level of drug costs more.

17 And I had a patient - again, I don't know if it was a
18 Premera patient - who had an \$80 copay for their drug. And
19 that's just often way too much for patients to afford. And
20 so ultimately, then, they either don't take the drug or they
21 take less of it or they split the pills in half or are doing
22 something like that because of that. And so --

23 Q And what is the medical consequence of that?

24 A Well, then those folks are going to have the consequences of
25 not taking their medication, which is the progression of the

1 underlying disease.

2 Q And has Premera - can you discuss for us Premera's contract
3 negotiation practices with your clinic?

4 A Well, as I mentioned earlier, Premera is about half of our
5 commercial business and so we are left in a position where
6 we don't have a lot of negotiating, sort of, ability with
7 them.

8 And over the years we have asked and tried to, sort of,
9 negotiate a fee schedule and we were told that they don't
10 like to have different fee schedules and so we never were
11 able to make much progress in that regard.

12 Q So are there negotiations with Premera over what they pay
13 you for your medical service?

14 A Not in our group.

15 Q And why is reimbursement important?

16 A Well, again, in the current environment, reimbursement -
17 expenses to maintain our offices and the overhead and
18 particularly the administrative burden are increasing such
19 that the reimbursements are not keeping up with that and so
20 it is for important for physicians - all health providers -
21 to really pay close attention to that because ultimately if
22 your reimbursements are not keeping pace with the rise in
23 your specialty, you will not be able to stay in business any
24 longer.

25 Q And what is the link between the inadequate reimbursement

1 and access to patient access to care?

2 MS. EMERSON: I'm going to object. This is beyond
3 the scope of Your Honor's ruling concerning the initial
4 prefiled direct testimony that was proffered by the WSMA.

5 JUDGE FINKLE: You need to confine the question
6 within the nonexpert areas. Perhaps you can phrase the
7 questions in terms of personal experience.

8 MR. COOPERSMITH: Well, okay. Your Honor, we
9 vigorously dispute that characterization.

10 Q (BY MR. COOPERSMITH) But what has your experience been
11 about the link between reimbursement and access by patients
12 to care?

13 A Well, in our state there have been many physicians and a
14 couple of fairly prominent groups who have gone out of
15 business because --

16 MS. EMERSON: I need to reassert my objection
17 because the witness is proffering expert testimony.

18 MR. COOPERSMITH: Your Honor, in the interest of
19 time, we will move on.

20 Q (BY MR. COOPERSMITH) Are you aware of examples where low
21 reimbursement rates have affected a physician's desire to
22 practice in our state.

23 A Well, in our own group - I mean, we have had several folks
24 that we have interviewed for physicians who reasonably liked
25 Spokane, they liked the group, they think it is a reasonable

1 practice situation, but because our reimbursement rates are
2 lower and, in fact, our salary for our physicians are lower,
3 they have chosen to go elsewhere.

4 Q And can you be more specific about the costs that your
5 clinic incurs?

6 A In terms of?

7 Q How they have increased in the past few years, if at all.

8 A Well, if - the overall costs of just the overhead in our
9 group - in our group has gone up about 20 percent in the
10 last few years or over that period of time. And obviously
11 that's - not unlike other parts of the country - that is
12 greater than the rate of inflation. That is greater than
13 the rate of our reimbursement increase.

14 Q Including from Premera?

15 A Yes.

16 Q And can you tell us about the staffing levels at your clinic
17 over the past few years?

18 A Well, our clinic is not unique, but as a specific example
19 when I - this is a really long period of time, when I first
20 started in practice, we had about two staff people per
21 physician and now we have actually about five staff people
22 per physician, which is slightly less than average so it has
23 gone up scantily.

24 Q Are those added staff involved in patient care?

25 A Virtually all of our additional staff have been in the

1 business office, so they have not been nurses and, you know,
2 receptionists. It has been billing and collecting, doing
3 those sorts of things in the billing office.

4 Q Can you tell us what the average pay is at your clinic?

5 A The median in our group, it ends up been \$46 an hour.

6 Q And don't neurosurgeons make a lot more?

7 A And so they should. Neurosurgeons do. Neurosurgeons
8 typically make in the \$300,000 to \$400,000 range. And - but
9 sort of in their defense, you know, they go to medical
10 school. They have minimum of seven years of training. They
11 get out in their mid 30s and have a practice life of maybe
12 25 years - 20 to 25 years. And they get to pay \$120,000 in
13 malpractice insurance. And so I think that that's not an
14 unreasonable sort of compensation for their work.

15 Q And, Dr. Collins, in your experience, does the Premera
16 contract influence the actions of other insurers in Eastern
17 Washington?

18 MS. EMERSON: Objection. We are getting into the
19 area of expert testimony.

20 JUDGE FINKLE: Sustained.

21 MR. COOPERSMITH: That was a question about his
22 experience and what happens at his clinic. Is that question
23 permissible?

24 JUDGE FINKLE: Yes.

25 Q (BY MR. COOPERSMITH) Okay. You may answer the question.

1 A Well, I know that in our clinic when we evaluate contracts
2 from other commercial payers, Premera has become the
3 yardstick by which they're evaluated, so it sort of sets the
4 bar for the other --

5 Q And, in fact, when you look at the - well, strike - we'll
6 move on.

7 Are you concerned that Premera's conversion might cause
8 premiums to rise?

9 MS. EMERSON: Same objection, Your Honor. This
10 relates to prefiled direct testimony, a specific paragraph
11 that was expressly stricken pursuant to the motion to
12 exclude the expert testimony that was proffered.

13 MR. COOPERSMITH: Again, we disagree, but we can
14 rephrase the question.

15 Q (BY MR. COOPERSMITH) What is the medical consequence, in
16 your experience, in an increase in premium.

17 MS. EMERSON: Same objection, Your Honor.

18 JUDGE FINKLE: Overruled.

19 Q (BY MR. COOPERSMITH) You may answer the question. And now
20 you are confused.

21 What is the medical consequences of a rise in premiums,
22 in your experience?

23 A Well, when premiums go up, several different things happen,
24 but ultimately, the burden - the financial burden is shifted
25 more towards the patients and their use of care goes down.

1 And so we see people coming into the office less. We see
2 more pressure to, sort of, treat over the phone. You see
3 more people who end up going to the emergency room because
4 they made the decision earlier on in the process not to go
5 in to see their physician earlier. And so we - I think we
6 see - those are the kinds of medical consequences.

7 Q And Premera asserts that it has a high level of satisfaction
8 among physicians as shown in a survey that it commissioned.
9 What do you think of those results?

10 A I'm not actually familiar with the survey. I don't think I
11 was one of the people who was surveyed, but I would say it
12 was be at odds from what I'm hearing as I have gone across
13 the state.

14 And I've been president of the state association since
15 September, so I have been east and west and to Omak and
16 Seattle and all kinds of places and that would be - that
17 would not be the impression that I would get from the folks
18 who talked to me.

19 Q Have - is there any fear of reprisal by physicians from
20 Premera?

21 A That was actually fairly interesting to me because I didn't
22 expect that and that's - as I have talked to people over
23 last few months and they have related their stories of - of
24 some of their struggles, I said, "Well, what if they asked
25 me who told me this? Can I give them your name?"

1 And with one exception, they said, "Oh, no, don't use my
2 name. This has to be confidential."

3 And the reason is that they were concerned about what
4 would happen to them when they had to go negotiate with
5 Premera because, again, it is such a big player.

6 Q Have you had any doctors come up to you in the course of
7 your travels, Dr. Collins, and object to the WSMA's
8 opposition to the conversion and say that the WSMA is
9 mischaracterizing Premera?

10 A I have had a couple, but, again, distinctly in the minority.

11 Q And can you give us a quick summary of why the WSMA opposes
12 the conversion?

13 A The WSMA is opposed primarily because we are concerned about
14 availability and affordability and access for our patients.

15 MS. EMERSON: If I may please object here, Your
16 Honor. This is squarely within the scope of the expert
17 testimony that was excluded because this witness was not
18 proffered as an expert witness.

19 JUDGE FINKLE: He is expressing the organization's
20 position. I don't think it is expert testimony. Objection
21 is overruled.

22 Q (BY MR. COOPERSMITH) You can continue, Dr. Collins.

23 A Our concern is that in the difficult economic environment
24 that physicians' offices already face, that the conversion
25 would lead to increased premiums, decreased, sort of, access

1 for patients, increased difficulties for physicians in sort
2 of maintaining their offices. And so we are concerned that
3 it will have a direct negative impact on those patients and
4 particularly in places like where I'm from in Eastern
5 Washington, which is sort of sparsely populated and not -
6 obviously not a part of the state that other insurers are
7 aggressively interested in moving into.

8 So we are - that's the basis of our concern and I'm not
9 sure - if you think about, you know, sort of risks and
10 benefits, we are not convinced that there is commensurate
11 benefit to the --

12 Q And, Dr. Collins, were you paid for your testimony today?

13 A No.

14 Q And if you weren't here testifying with us today, what would
15 you be doing?

16 A Well, I made rounds this morning at five in the morning so I
17 could catch a plane plain over here. And if I weren't here,
18 I would be back in the office probably until 6:00 tonight.

19 Q Thank you, Dr. Collins.

20 MR. COOPERSMITH: No further questions at this time.

21 JUDGE FINKLE: Have you agreed on the batting order
22 here?

23 MS. deLEON: We have no questions.

24 MS. EMERSON: I do have a few.

CROSS-EXAMINATION

BY MS. EMERSON:

Q Good afternoon, my name is Ramona Emerson.

Dr. Collins, you just expressed some concerns that your organization has with respect to the conversion. Have you - you are not an economist, are you?

A I'm not.

Q And you personally have not studied the impact of the proposed conversion on premiums, reimbursements rates, access issues, have you?

A Not personally studied that.

Q Can you tell us a little bit more about your practice?

First of all, it is a primary care practice; correct?

A That's correct.

Q Now, your practice is not limited to treating patients that reside only in Spokane County, is it?

A It is not.

Q And I understand that you personally attract patients from areas such as other parts of Eastern Washington, Northern Idaho, Western Montana; is that right?

A That's correct.

Q So I take - I take it that you see some patients from Othello?

A I don't think I have anybody from Othello.

1 Q I'm sorry. Orville?

2 A Yes.

3 Q How about --

4 A I do have a couple in Orville.

5 Q How about the Tri-Cities?

6 A Yes.

7 Q Lewiston, Idaho?

8 A A couple.

9 Q Libby, Montana?

10 A A couple.

11 Q Now, your prefiled testimony noted that your clinic
12 contracts with all the major insured health plans that
13 provide PPO coverage; is that right?

14 A I didn't get the question.

15 Q Let me repeat it. Your prefiled direct testimony indicated
16 that your clinic contracts with all the major carriers of
17 health insurance; is that right?

18 A Not exactly. I don't believe we have a Group Health
19 contract.

20 Q I'm sorry?

21 A I don't believe we have a Group Health contract.

22 Q Okay. But you do contract with Aetna?

23 A We do.

24 Q And CIGNA?

25 A Yes.

1 Q United?

2 A Yes.

3 Q FirstChoice?

4 A Yes.

5 Q And One Health; is that right?

6 A I'm not sure about One Health.

7 Q Would it refresh your recollection to take a look at your
8 prefiled direct testimony, and in particular, Paragraph 36?

9 A Okay. I guess we must.

10 Q Well, that's what you said in your prefiled direct.

11 A Okay.

12 Q Now, we heard testimony this morning that Regence Asuris has
13 a fairly large - fairly large number of patients in Spokane
14 County. Does your clinic happen to contract with Regence
15 Asuris?

16 A We do.

17 Q Now, you also state in your prefiled direct testimony that
18 about one-third of your patients are Medicare patients; is
19 that right?

20 A That's correct.

21 Q Now, isn't it true that your practice at this time is closed
22 to new Medicare patients?

23 A It is.

24 Q And, at this time, it is also closed to new Medicaid
25 patients; isn't that right?

1 A That's correct.

2 Q Now, Dr. Collins, you do have some familiarity with respect
3 to work that you do in connection with Premera management;
4 isn't that right?

5 A I'm not sure I understand that question.

6 Q That you - I'm sorry. Let me rephrase.

7 It is true that you have some familiarity with Premera
8 in connection with the work that you do along with Premera
9 management?

10 A In the clinic?

11 Q No. In particular, I'm referring to the work you do sitting
12 on Premera's credentialing committee.

13 A Yes.

14 Q Now, how long have you sat on Premera's provider
15 credentialing committee?

16 A I have been on that committee for five or six years.

17 Q And do you recall who it was that asked you to sit on that
18 committee on behalf of Premera?

19 A I believe it was Dr. Jim Watts, actually, who used to be on
20 Premera's board.

21 Q Now, as a member of that committee, you review the
22 applications and renewal applications of providers that are
23 seeking to join or remain a part of Premera's network; isn't
24 that right?

25 A That's correct.

1 Q And you sit on this committee along with Premera physicians
2 and other staff; is that correct?

3 A Yes.

4 Q And it is true, is it not, that based on the work that you
5 do with Premera and its physicians and staff on that
6 committee, that you have concluded that Premera has acted in
7 a fair and professional manner in the credentialing
8 decisions that it has made; is that correct?

9 A That's correct.

10 Q Okay. Now, despite what you observed from your dealings
11 with Premera in the capacity in which you get to view the
12 company from the inside, you have identified a number of
13 concerns that you have when dealing with Premera
14 administration; correct?

15 A Correct.

16 Q Now, you claim that Premera is among the most difficult of
17 insurance companies to work with; is that correct?

18 A That was in my testimony, yes.

19 Q Now, I take it from your testimony that you also experienced
20 difficulty when you deal with other health plans, as well?

21 A We certainly do.

22 Q Would you like to see administrative simplifications for
23 providers as a priority for all health plans?

24 A Yes.

25 Q Are you aware of Premera's work in this area?

1 A To a certain degree.

2 Q Now, let's talk about a couple of your concerns in
3 particular. I'm curious - first of all, you claim that you
4 have difficulty getting approval from Premera for tests and
5 procedures. Do you know how many years ago it was that
6 Premera stopped requiring preauthorizations for things like
7 tests and procedures?

8 A No.

9 MR. COOPERSMITH: Objection. Fact not in evidence.

10 JUDGE FINKLE: Sustained.

11 MS. EMERSON: Well, actually, for the record, I
12 would point out that Dr. Chauhan in his prefiled responsive
13 testimony did indicate that it has been a few years since
14 Premera has required any preauthorizations for tests and
15 procedures.

16 JUDGE FINKLE: Go ahead.

17 MR. COOPERSMITH: That is different from what
18 counsel just argued, but - we are aware that Premera asserts
19 that it no longer requires preauthorization, but that is
20 different from saying that that is, in fact, the case.

21 JUDGE FINKLE: I sustained your objection --

22 MR. COOPERSMITH: Thank you, Your Honor.

23 JUDGE FINKLE: -- so go ahead.

24 Q (BY MS. EMERSON) Are you sure, Dr. Collins, that you aren't
25 confusing preauthorizations that are required by other

1 health plans with Premera?

2 A When dealing with insurance companies and with Premera in
3 particular, I don't think I can ever be sure. And it is
4 always difficult to know what requires preauthorization and
5 what doesn't require preauthorization.

6 And what we try to do in the office is to be an advocate
7 for our patients who also want to know before we order an
8 expensive test or procedure for them, is it likely to be
9 paid for. And I'm not sure, even though we do interact with
10 Premera a fair amount, how you do that all the time.

11 Q So, Dr. Collins, is what you are referring to with respect
12 to preauthorizations, is that really what Premera refers to
13 as benefit advisories?

14 A That's a relatively new thing, I believe. See, from our
15 point of view, what we see is we order something and the
16 next thing we know the patient is on the phone saying,
17 "Premera is not going to pay for this."

18 Q I'm sorry. I'm sorry. My question simply called for a
19 "yes" or "no" answer.

20 MR. COOPERSMITH: The witness was trying to answer
21 the question.

22 JUDGE FINKLE: Go ahead and answer the question.

23 THE WITNESS: Please repeat it.

24 Q (BY MS. EMERSON) Is it possible that what you are confusing
25 as a mandatory preauthorization really is what Premera

1 refers to as a benefit advisory? Yes or no?

2 A No.

3 Q Are you aware that benefit advisories are voluntary from
4 Premera's perspective?

5 A Yes.

6 Q Now, in your prefiled direct testimony also it expresses
7 some frustration. And you talked today about some
8 frustrations or concerns you have when it comes to Premera's
9 prescription drug coverages and you stated it is difficult
10 to know whether a drug is or is not covered and you have
11 claimed that Premera's formulary is confusing.

12 Dr. Collins, are you not aware that Premera's formulary
13 includes all drugs for covered conditions?

14 MR. COOPERSMITH: Objection. Argumentative.

15 JUDGE FINKLE: Sustained.

16 Q (BY MS. EMERSON) Dr. Collins, do you have an understanding
17 that Premera's formulary includes all drugs for covered
18 conditions?

19 A I understand --

20 Q Yes or no?

21 A I understand that it does.

22 Q You have also testified today that decisions - Premera's
23 decisions about what drugs to cover seem to be driven
24 primarily by financial motives. Was that your testimony?

25 A Yes, it was.

1 Q Are you aware that all decisions about Premera's
2 prescription drug coverages are made only by independent
3 pharmacy and therapeutics committee?

4 MR. COOPERSMITH: Objection. Do I need to specify?

5 JUDGE FINKLE: Probably not. Sustained.

6 Q (BY MS. EMERSON) Dr. Collins, do you have an understanding
7 that the decisions about Premera's prescription drug
8 coverages are made only by an independent pharmacy and
9 therapeutics committee?

10 MR. COOPERSMITH: Objection. That fact is not in
11 evidence.

12 JUDGE FINKLE: Sustained.

13 Q (BY MS. EMERSON) Dr. Collins, do you know who makes the
14 decisions about whether - about what drugs to include on
15 Premera's formulary?

16 A I don't.

17 Q Have you heard of Premera's independent pharmacy and
18 therapeutics committee?

19 A Just this afternoon.

20 Q You didn't read about it in Dr. Chauhan's responsive
21 testimony?

22 A I don't remember that.

23 Q Do you recall reading anything Dr. Chauhan's testimony that
24 no Premera employees participate in this committee's
25 decisions about prescription drug coverage?

1 A I don't remember that.

2 Q Dr. Collins, I take it that in your position as WSMA
3 leadership and formerly with Spokane - the medical
4 organizations leadership there, that you have some
5 understanding and you talk about prescription drug coverages
6 by different clinics; is that right?

7 A Clinics don't cover prescriptions.

8 Q Well - or about the coverages that --

9 A Are you talking about insurance benefits?

10 Q Let me ask the question differently. I think this is a
11 little confusing.

12 A Okay.

13 Q Are you aware that there are some clinics that have adopted
14 the Premera formulary as being superior to their own?

15 MR. COOPERSMITH: Objection, Your Honor.

16 JUDGE FINKLE: Sustained. It is the "are you aware"
17 that keeps getting you in trouble. So if you rephrase it,
18 you will be fine.

19 Q (BY MS. EMERSON) Do you have some understanding that some
20 clinics have adopted Premera's formulary as being superior
21 to their own?

22 A I did not know that.

23 Q And, Dr. Collins, do you - are you familiar with Premera's
24 care facilitation programs?

25 A I know a little about them having had a presentation from

1 one of the medical directors maybe two or three months ago.

2 Q And do you have - are you familiar with the recognition that
3 Premera's care facilitation has received by the medical
4 community?

5 A No.

6 Q Dr. Collins, were you here last Friday to hear Brian
7 Ancell's testimony?

8 A I was not.

9 Q Did someone share with you Mr. Ancell's testimony about
10 Premera's efforts to work with providers and to improve
11 administrative simplification?

12 A Not in detail.

13 MS. EMERSON: Thank you. No further questions at
14 this time.

15

16 REDIRECT EXAMINATION

17

18 BY MR. COOPERSMITH:

19 Q Dr. Collins, you just stated that your clinic did see
20 Regence patients; is that correct?

21 A That's correct.

22 Q And those patients are less than five percent of the private
23 insurance --

24 MS. EMERSON: Objection.

25

1 (Interruption by reporter due
2 to overlapping conversation.)

2

3 MR. COOPERSMITH: Let me rephrase the question.

4 Q (BY MR. COOPERSMITH) You stated in your earlier testimony
5 that the second largest private insurance carrier for your
6 clinic is PHCO with five percent; is that correct?

7 A That's correct.

8 Q Does that make Regence, then, have fewer than five percent
9 of the patients?

10 A That's correct.

11 Q And is that the same for the other carriers that the Premera
12 attorney mentioned in her questions to you?

13 A That's correct.

14 Q And why is your practice now closed to new Medicare and
15 Medicaid patients?

16 A Well, it's - it is a decision that we made as a group
17 because of the same overhead pressures that I was describing
18 earlier. And it is the - as the overhead pressures have
19 continued to increase and our reimbursements have remained
20 relatively flat - they have increased, it is not that they
21 haven't increased, they have not kept pace with the increase
22 in our overhead - we had to look both to Medicare and
23 Medicaid because they are very low payers.

24 And so a couple of years ago, the WSMA actually did a
25 study that suggested if your combination in the

1 Medicare/Medicaid was over 24 percent, your clinic was at
2 financial risk. At that point in time, although my personal
3 was at 33 percent, the clinic was at 52 percent. And so we
4 made a decision at that point that we could not sustain a
5 higher Medicare load than we were already carrying.

6 Q And with regard to prescription drugs, has it been your
7 experience that when you try to prescribe drugs that your
8 patient needs, that you ultimately have to deal with
9 Premera?

10 A Frequently that's the case. And if I could elaborate, I
11 understand that all the drugs are on the formulary, but they
12 are - in most plans, maybe not all, they are tiered. And so
13 that the generic drugs are lowest here and may be relatively
14 an inexpensive copay. An average copay may be \$10 or \$15.

15 But as you move into the second and third tier, they
16 become more expensive. So technically they are available,
17 but realistically they may not be available.

18 Q And is it - is it harder for people who have multiple
19 conditions or who use multiple medications to afford the
20 drugs on the more expensive tiers, in your experience?

21 A Absolutely. You know, that's one of the complexities in -
22 particularly in internal medicine when we deal with people
23 with chronic conditions. They have two or three chronic
24 conditions. They don't just have lung disease or diabetes,
25 they have a bunch of other things, so their medication lists

1 kind of grow exponentially. And the more you do that, the
2 more they may require a specific drug as opposed to the one
3 that happens to be in the first tier.

4 Q Okay. And the Premera attorney asked you several questions
5 about the benefit advisory form. And did you bring
6 documentation today related to a particular patient with a
7 benefit advisory form?

8 A I did bring a couple.

9 MR. COOPERSMITH: Yes, Your Honor, we ask permission
10 to approach the witness.

11 MS. EMERSON: Your Honor, I'm going to object.
12 There have been prior rulings in this case establishing that
13 it is untimely to be proffering new documents that should
14 have been produced by the April 26th deadline set forth in
15 your order.

16 JUDGE FINKLE: Is this a new document?

17 MR. COOPERSMITH: It is, Your Honor. And it is
18 offered for impeachment purposes only for previous testimony
19 from Premera executives.

20 JUDGE FINKLE: Well, I guess I'll look at it, but
21 let's bring it up and distribute it. I want to see it.

22 MR. COOPERSMITH: Good thing we are not being judged
23 on gracefulness.

24 This document has been redacted so that there is no
25 personal patient information disclosed, just for the record.

1 Q (BY MR. COOPERSMITH) Dr. Collins, I'm giving what you has
2 been mark as Intervenors Exhibit 123. Can you identify that
3 for us briefly?

4 MS. EMERSON: Your Honor, if I could object here. I
5 believe that it is improper to be introducing these
6 documents at this late date. If - if Mr. Coopersmith
7 thought that there was an opportunity for impeachment, which
8 I don't concede exists here, he - the time to address the
9 prefiled direct testimony of any Premera executives would
10 have been at the time that they testified live in this
11 proceeding.

12 Mr. Ancell, Dr. Roki Chauhan, they were the two Premera
13 executives that provided testimony about Premera's
14 relationships with providers and addressed the issue of
15 Premera not requiring preauthorizations. And it is improper
16 for counsel to be introducing this document now, especially
17 at a time when these witnesses, they have come on and off
18 the stand and they have no opportunity to be examined in
19 connection with the context of this document that is now
20 before us.

21 JUDGE FINKLE: I'm going to allow the witness to
22 identify document without describing it.

23 I need you to go ahead and make your record.

24 MR. COOPERSMITH: Sure.

25 Q (BY MR. COOPERSMITH) Have you seen this document before?

1 A I have.

2 Q And without divulging the name of the patient involved, of
3 course, can you tell us what it is?

4 A This is a request for a benefit advisory.

5 Q And is it a request that you made --

6 A It is.

7 Q -- for one of your patients?

8 A Yes.

9 Q And it is an accurate copy of that request?

10 A It is.

11 Q And can you . . .

12 MR. COOPERSMITH: Well, Your Honor, at this point,
13 again, we offer it through this witness because it is this
14 witness's personal experience that rebuts testimony offered
15 by Premera executives regarding benefit advisories.

16 JUDGE FINKLE: I'm going to sustain the objection to
17 the document itself. You can certainly question him about
18 the experience.

19 MR. COOPERSMITH: Terrific. Thank you.

20 Q (BY MR. COOPERSMITH) Do you recall the request date for
21 this benefit advisory?

22 A March 9th.

23 Q And do you recall when you first got a response?

24 A March 17th.

25 Q And did the March 17th response resolve the issue?

1 A It did not.

2 Q And who conducted the medical review in this case?

3 A An LPN.

4 Q Okay. And according to your understanding of the benefit
5 advisory, it is voluntary to obtain it; is that correct?

6 A That's correct.

7 Q But is there any obligation on Premera's part to pay a
8 physician for the care that they give?

9 A Even if it had been approved, no.

10 Q Does Premera reserve the right to disapprove a claim even
11 after it has been approved through the voluntary benefit
12 advisory?

13 MS. EMERSON: Objection. Leading. Lack of
14 foundation.

15 JUDGE FINKLE: Well, you can ask him about his
16 direct experience. And I think the question is capable of
17 being answered yes or no, so I don't see it as being
18 leading. With that understanding, that it is your personal
19 experience we are talking about here.

20 A My understanding from the communication is that even if the
21 advisory is affirmative, it does not guarantee payment.

22 Q (BY MR. COOPERSMITH) And you mentioned that you found that
23 Premera conducted itself in a professional way in your
24 service on its credentialing committee?

25 A I did.

1 Q And do you dislike Premera?

2 A I do not. I - I think that there is normal tension between
3 payers and providers and there is certainly difficulties as
4 has been suggested with many of the carriers that we have.
5 And I actually would like Premera to continue to be a
6 contributing part of our local healthcare team, however I
7 don't think that conversion is going to help us in that
8 regard.

9 Q And do you stand by your testimony that Premera is amongst
10 the most difficult health insurers to deal with for
11 physicians?

12 A You know, I saw that in the testimony and I really did think
13 about that and I do think that the sum of my experience is
14 that it is.

15 MR. COOPERSMITH: Thank you. No further questions
16 at this time.

17 MS. DeLEON: No questions.

18 JUDGE FINKLE: I don't meant to ignore the other
19 Interveners. I'm assuming no questions.

20 MR. COOPERSMITH: Yes, Your Honor. Thank you.

21 MS. EMERSON: Just one follow-up question.

22

23

24

25

RECROSS-EXAMINATION

BY MR. EMERSON:

Q You indicated that you were surprised when you saw the words in your prefiled direct testimony that Premera was among the most difficult providers to work with. Did you write those words yourself?

A No, I said them.

MS. EMERSON: Okay. No further questions.

MR. COOPERSMITH: Nothing further, Your Honor. The Commissioner may want to ask you a few questions.

THE WITNESS: I'm new here.

EXAMINATION

BY COMMISSIONER KREIDLER:

Q Dr. Collins, one of the items that was before us earlier was a survey that was done of Washington physicians showing a high degree of satisfaction with Premera.

That - the company that was contracted with by Premera to conduct that survey made it clear that there would be no connection to the physicians who responded to the survey as to identification by Premera, but the survey still came back with results that were showing a high degree of satisfaction among physicians.

1 You weren't here to hear just exactly what that survey
2 was and how it was conducted and possibly, by your response,
3 you weren't one that was queried to see if you wanted to
4 respond to it.

5 Do you still think on the issue of confidentiality and -
6 that there are concerns on the part of physicians when they
7 respond to a survey even if it is said that there would be
8 no connection or identifier with them individually?

9 A You know, I don't know that there would be. I think what is
10 perhaps - I don't know if I can speculate. I mean, I think
11 I don't think it would be a big concern, but I do think
12 that, again, just from what I'm hearing folks who are really
13 hot probably wouldn't bother with it. You know, you see a
14 Premera thing - that's what I mean, you see a Premera thing
15 and you just want to throw it away, you know.

16 Q Mm-hmm. I'm curious, in your capacity as being a board
17 member of the Washington State Medical Association for now a
18 number of years as you have worked your way through the
19 chairs to be now president, do you go to national meetings
20 of the American Medical Association?

21 A I do.

22 Q Out of curiosity, in that capacity, what has been your
23 experience when - or maybe there is formal position relative
24 to the conversion on the part of the Medical Association in
25 states that have faced conversion issues on the part of what

1 might become considered organized medicine?

2 A I don't believe they have an official policy on all
3 conversions, but they have chosen to oppose them in certain
4 circumstances. And I can't reiterate for you which ones,
5 but I know they have take some opposition to some
6 conversions.

7 Q Do you know whether there has been --

8 A And I'm speaking about the AMA.

9 Q AMA. Right.

10 From those states where this has been an issue, have you
11 ever been in a position supporting a conversion, to the best
12 of your knowledge?

13 A Not that I'm aware of.

14 Q In those states where conversion has taken place, has there
15 ever been, in your experience or in your conversations with
16 colleagues from across the country, an interpretation of
17 what the impact of conversion is represented to the
18 physicians in that particular state?

19 A The information that I have heard is that the reimbursements
20 to providers did go down and that the premiums to the
21 employers went up , so . . .

22 COMMISSIONER KREIDLER: Very good. Thank you very
23 much. No further questions.

24 MS. DeLEON: No questions.

25 MS. EMERSON: No questions.

1 MR. COOPERSMITH: No questions, Your Honor.

2 JUDGE FINKLE: Thank you. Please step down.

3 MR. COOPERSMITH: And thank you, again, to the
4 parties for accommodating Dr. Collins' schedule.

5 MR. HAMJE: Your Honor and Commissioner, the OIC
6 staff intends to call next Marty Staehlin to the stand, but
7 I thought when everyone is seated it might be a good time
8 for us to address than issue raised by you, Judge Finkle,
9 about the Alaska Division of Insurance's communication with
10 the Commissioner. And maybe we could discuss that for just
11 a minute or two.

12 JUDGE FINKLE: Sounds good. Let's let everyone else
13 get organized.

14 Okay. I think we are ready.

15 MR. HAMJE: I don't want to make a big deal about
16 all of this. As you know, we had not had a chance to really
17 look at this until yesterday evening and it is a very
18 significant document from our standpoint. And we do believe
19 very firmly that we need to address it and address it here
20 and now.

21 Now, as you know, the Blackstone Group, which also
22 delivered an opinion with respect to the share allocation,
23 is now - well, the witnesses are back in New York, if all
24 went well on their trip back. And so - but we do have
25 Mr. Staehlin who has spent some time last night and

1 yesterday reviewing this. And he does have some, I think,
2 significant comments about it that we do want to go ahead
3 talk about. And so what I'm suggesting is two things: One,
4 is that we would like to have a little bit of extra time
5 beyond just I think the regular half-hour plus that we have
6 been covering so far on direct so we could talk a little bit
7 about these additional - this new information.

8 But we also like to ask that we be given an opportunity
9 if the record could be left open so that we could submit
10 written responses from both the Blackstone Group and
11 PricewaterhouseCoopers. I would propose that we be given a
12 time until May 28th, which is the date that briefs are due,
13 to just have written responses since this is something
14 brand-new and I think our people are going to need to take a
15 look at it.

16 But those are the only two items that I had to - to
17 present prior to Mr. Staehlin's testimony.

18 MR. KELLY: On the first issue, Premera has no
19 problem with him speaking on that if it is limited to that
20 purpose. But I think for clarity, it ought to be done as
21 Part Two of his testimony after we finish Part One this
22 afternoon, his normal expected testimony. So I would just
23 propose he testifies as to everything else, we cross back
24 and forth and then we call a halt to that and you can put on
25 Mr. Staehlin again to testify about that. And, of course,

1 that would be on their time.

2 On the second part, I'm a little concerned that it be as
3 late as May 28th, that's the deadlines for the briefs. I
4 can understand they made need some time, but we don't know
5 what is going to be said. I would suggest it be something
6 like May 22nd, May 21st.

7 MR. HAMJE: May 21st is a little bit too soon,
8 certainly too soon. And also this would only be subject and
9 only discussed in the issues related to the share
10 allocation. It would real- - should have no impact
11 whatsoever on Premera.

12 And with respect to having a bifurcated testimony from
13 Mr. Staehlin, I certainly would resist that. I think that
14 he could go ahead and add on to the tail end and - of his
15 testimony and then we can just proceed with
16 cross-examination about whatever the parties want to
17 cross-examine about, whether it is share allocation or
18 anything else.

19 MS. MCCULLOUGH: Thank you. As to the first
20 question, we have absolutely no objection to allowing for
21 extra time for Mr. Staehlin to testify in allocation today.
22 And I agree with Mr. Hamje, that there is reason to
23 bifurcate that testimony.

24 As for the second part, I don't think there is any
25 reason for the record to be left open for responses by

1 Mr. Koplovitz or Mr. Staehlin. The two states have been
2 working on the allocation issue for nearly two years now.
3 The - the Washington experts have had the allocation
4 experts' reports - at least their preliminary reports since
5 October of 2003 and they have had numerous discussion - or
6 at least it is my understanding that they have had numerous
7 discussions about the differences between their two -
8 between the two states' methodologies and conclusions.

9 So I don't believe there is any basis for leaving the
10 record open. If there is a basis for it, then we should be
11 granted the opportunity to somehow be able to cross-examine
12 them on that response or to be able to submit something
13 either rebutting or responding whatever they file.

14 JUDGE FINKLE: Any response from other Intervenors?

15 MS. HAMBURGER: We agree with the OIC staff on this
16 issue and we would like them to have the opportunity to
17 respond.

18 JUDGE FINKLE: Anything further from Staff or
19 Premera on this point?

20 Let me ask a question. Assuming I'm going to give an
21 opportunity for further submission, would anyone wish an
22 opportunity to respond to that submission before the
23 deadline, May 28th? That is, do you want a gap?

24 And I will say, just so you are focusing on this, I
25 believe that we will respond (sic) to a written report from

1 Alaska as long as it is responsive. I don't believe that
2 further cross-examination is in order. Recognizing you may
3 not agree with that ruling, that's what it will be.

4 And so I want you to focus on whether an earlier date,
5 such as May 25, giving you a brief opportunity to
6 incorporate material into the final submission would be
7 helpful or is that not helpful?

8 MS. McCULLOUGH: Yes, we would - we would appreciate
9 having some time to respond. And I don't know what dates,
10 you know, May 25th and 28th fall on, but if it is a weekend,
11 we prefer a couple of extra days. So I don't think - it
12 would be better if it was pushed back to the 22nd or the
13 23rd.

14 MR. HAMJE: I think the 21st is a Friday.

15 JUDGE FINKLE: I thought I was plugging ahead to a
16 Tuesday to give you a few days. There is no magic in the
17 precise dates, but I was --

18 MR. HAMJE: Your Honor, the 25th is a Tuesday and I
19 have just conferred at least with PricewaterhouseCoopers'
20 consultants and they have both indicated that the 25th could
21 probably be a day that they could make. We still would need
22 to check with Blackstone. I would hope that the investment
23 banking issues are not horribly complex, but, you know, we
24 will try to go with the 25th, if that will be workable.

25 JUDGE FINKLE: I agree, to an extent, with the

1 Alaska Intervenors' viewpoint that it is not totally
2 shocking issues, but I do want you to have an opportunity to
3 respond.

4 So any other comments before I finalize? The deadline
5 will be the 25th. We will keep the 28th - May 28th deadline
6 for posthearing submissions.

7 MR. HAMJE: Thank you, Your Honor. Unless there is
8 something else about this, then --

9 JUDGE FINKLE: I'm sorry. I will not bifurcate the
10 testimony. You can go ahead and present it all.

11 MR. HAMJE: We would then call Martin Staehlin to
12 the stand, please.

13
14 MARTIN STAEHLIN, having been first duly
sworn by the Judge,
15 testified as follows:

16 JUDGE FINKLE: Please sit down.

17
18 DIRECT EXAMINATION

19
20 BY MR. HAMJE:

21 Q Please state your name and business address.

22 A Martin Ernest Staehlin, One North Wacker, Chicago.

23 Q Please describe your current position.

24 A I am a director in the healthcare consulting group for
25 PricewaterhouseCoopers, LLP.

1 Q What does it mean - what do you mean - what does it entail
2 being a member of the healthcare service group?

3 A We serve on a healthcare consulting basis of various clients
4 including health plans, including HMOs, employer groups, in
5 designing and monitoring their employee benefit programs.

6 We also work for provider entities, sometimes PHO
7 providers, sponsored organizations, sometimes the providers
8 themselves and the design of their compensation programs and
9 their interactions with health plans. And we also work for
10 state insurance departments for a variety of reasons.

11 We advise on Medicaid - Managed Medicaid programs. We
12 assist in triennial exams which is a process that insurance
13 departments use to monitor the insurance business in their
14 state. And in some states we also work for the insolvency
15 division, which in some states is in different divisions in
16 monitoring health plan performance.

17 Q Please describe your educational background.

18 A I have a bachelor's of science degree from Brown University,
19 bachelor's of science in applied mathematics.

20 Q Do you belong to any professional organization?

21 A Yes. I am a fellow of the Society of Actuaries and a member
22 of the American Academy of Actuaries.

23 Q Do you meet the continuing education requirements for these
24 organizations?

25 A Yes, I do. So I am both - meet the continuing education

1 requirements for the actuarial societies, but I would like
2 to add that being a member of PricewaterhouseCoopers, we
3 have additional continuing education requirements regarding
4 both the standards that PricewaterhouseCoopers uses for its
5 employees, but also for the area in which you practice on
6 behalf of PricewaterhouseCoopers. And I meet those
7 continuing education requirements also.

8 Q Are you qualified to render public statements of actuarial
9 opinions?

10 A Yes, I am. And there are a variety of public statements of
11 actuarial opinion which are detailed in the actuarial
12 literature. And PricewaterhouseCoopers has requirements
13 that you are approved for each of those public statements of
14 actuarial opinion. And I am approved for all public
15 statements of actuarial opinions for PricewaterhouseCoopers.

16 Q Please describe your experience that is relevant to PwC's
17 engagement in this matter.

18 A I was involved in several demutualizations, for example, Met
19 Life and General American, but in addition I practice in an
20 area that analyzes the experience of a health plan over
21 time.

22 And the reason that's important in this case is we had
23 to analyze the experience of Premera Blue Cross and its
24 predecessor organizations from somewhere in the mid 1940s
25 until today, approximately 60 years. So in looking at - you

1 not only look at a snapshot or what something might look at
2 today, but you have to adjust for what might be going on
3 today and - historically and in the future.

4 And in the case of Premera, although you look at their
5 experience - they just wrote the Microsoft account. So they
6 are playing in a bigger space on large account. They just
7 redesigned their product portfolio, so they are in something
8 called Dimensions. And they are making changes
9 consistently.

10 Historically, they had a merger with MSC and in the
11 future, we have been advised, that they are drawing from
12 PEPB account and they are transferring Healthy Options and
13 Basic Health. So if you would look at Premera in a point of
14 time, you could do one level of analysis, but you have to
15 factor in all of these other changes. And it is a standard
16 actuarial practice to normalize today's experience for what
17 has gone on in the past and what will go on in the future.

18 MR. KELLY: May I object to this narrative, for it
19 has nothing to do with his qualifications?

20 JUDGE FINKLE: Please ask another question.

21 Q (BY MR. HAMJE) My understanding was, Mr. Staehlin, you were
22 explaining why your experience is relevant to your
23 engagement.

24 Would you please continue to explain why your experience
25 is relative to PwC's engagement?

1 A I believe the qualifications of the work that I have done in
2 all the areas that I talked about were important in
3 analyzing Premera's experience over a period of time both
4 for their market conduct today and for the share allocation
5 that I was asked to opine on.

6 Q What was PwC asked to do that resulted in your involvement
7 in this matter?

8 A Sandra Hunt outlined a number of things that PwC was asked
9 to do. One of the things that I was asked to do is work
10 with a team of people to talk about the Economic Impact
11 Analysis of Premera's request to convert. So it was a team
12 - principally the people that we are talking about in this
13 testimony are Sandra Hunt, myself and Ed Gold. And that was
14 part of the team, but there were other people that were
15 involved. So that was one reason I was engaged.

16 And the second was that I was asked to come up with a
17 share allocation for the State of Washington as a result of
18 Premera's request to convert.

19 Q And what did PwC do to fulfill this engagement?

20 A Again, Sandra Hunt talked about - a lot about that. So I'm
21 going to highlight the fact that we gathered a lot of
22 documents from Premera, from the OIC. Some were found in
23 the discovery at the OIC related to Premera.

24 We received a lot of documents that were not just paper,
25 but that were electric transmissions. It had to do with

1 projections. And the projections were important to analyze
2 the future as well as the history, which a lot of the paper
3 supports.

4 So it was analyzing those documents to give opinions in
5 the two areas I talked about, economic impact analysis and
6 share allocation.

7 Q In connection with PwC's engagement, did you participate in
8 the preparation of several reports?

9 A I did.

10 Q Let me, just for speed, ask you quickly about them. Did you
11 work on the - what has been termed the "Economic Impact
12 Analysis," which is Exhibit S-1?

13 A Yes, I did.

14 Q The addendum report to that analysis, which is S-21?

15 A Yes.

16 Q Did you also prepare a report on share allocation, which is
17 attached to the Cantilo & Bennett opinion, on share
18 allocation, which has been designated S-23?

19 A Yes, I did.

20 Q Did you also prepare a report on actuarial analysis, which
21 is a final - a full report on the share allocation issue
22 which has been designated at S-24?

23 A Yes, I did.

24 Q Have you also submitted prefiled testimony in this matter?

25 A Yes, I have.

1 Q Did that include both prefiled direct testimony and prefiled
2 responsive?

3 A Yes, it included both.

4 Q Do you adopt your prefiled testimony and the reports and
5 portions of reports for which you were responsible?

6 A I do.

7 MR. HAMJE: At this time, Commissioner, it is - my
8 recollection is that Exhibits S-20 and S-21 have previously
9 been admitted, so we would offer at this time S-22, which is
10 Mr. Staehlin's curriculum vitae, S-23, which is the report
11 on share allocation, which is attached to the Cantilo and -
12 which is - was attached to the Cantilo & Bennett opinion on
13 that precise issue, S-24, the report on actuarial analysis,
14 S-61, which is Mr. Staehlin's prefiled direct testimony, and
15 S-62, which is his prefiled responsive testimony.

16 MR. KELLY: No objection.

17 MS. HAMBURGER: No objection.

18 JUDGE FINKLE: Admitted.

19 Q (BY MR. HAMJE) Now, Mr. Staehlin, let's - let's turn, if we
20 can, to - and I'm going to now focus on the economic
21 assurances that have been provided by Premera in this
22 matter.

23 Have - do you have any comments about those assurances?

24 A Yes, I do.

25 Q Would you go ahead and state your comments, please?

1 A Commissioner, I think I'm going to try and present a
2 compelling example of why the economic assurances that were
3 offered by the Washington consultants need to go at least
4 three years into the future, that's the future time frame
5 that they need to be enforced.

6 There has been a lot of testimony in this case, both in
7 this hearing and in the filed reports, that talk about the
8 rates in the State of Washington. And a lot of times it is
9 Eastern Washington versus Western Washington. And the
10 testimony has been offered by not only accredited actuaries,
11 including Ms. Halvorson of Premera, Mr. Lusk, Premera's
12 consultant, Ms. Lee for the OIC, and myself, consultant to
13 the OIC, but it has been offered by a number of people in
14 talking about what has happened to the rates, what is
15 expected to happen - expected to happen to the rates and
16 what is Premera's intent to effect the rates postconversion.

17 And much of this testimony talks about simple examples
18 of comparing rates in Eastern Washington and Western
19 Washington and why rates cannot go up in Eastern Washington
20 without them coming down commensurately in Western
21 Washington especially asserting - alleging constraints of
22 revenue neutrality.

23 And there are two significant flaws with most of these
24 arguments. And the first is that rates can be characterized
25 as a simple example and the second is that revenue

1 neutrality is as big an alleged constraint as one would
2 expect.

3 So the first point is that rates of individual and small
4 group regulated products in Washington are simple.

5 Q Mr. Staehlin, have you prepared a slide to illustrate this?

6 A Yes, I have.

7 Q And what . . .

8 MR. HAMJE: For the record, I would point out that
9 this is the third page of S-69, which has been submitted
10 previously by the Staff in April, but it is a redacted
11 versions because the original S-69 contains confidential
12 proprietary information. I have already shared a copy of
13 the document - or the slide - redacted slide with opposing
14 counsel.

15 MR. KELLY: Your Honor, if I could just have a
16 moment to look at S-69.

17 JUDGE FINKLE: Sure.

18 MR. HAMJE: In fact, I believe I have copies of S-69
19 right here. Maybe that will save some time.

20 JUDGE FINKLE: All set?

21 MR. KELLY: Yes. Thank you.

22 MR. HAMJE: May I proceed?

23 JUDGE FINKLE: Yes.

24 Q (BY MR. HAMJE) If we could go ahead and have the slide put
25 up, if we could do that.

1 Great. It is on there.

2 A Okay. The example is similar to the one you are looking at
3 on the unredacted S-69, but because there is some
4 proprietary information, we have simplified it for purposes
5 of the slide to show - give an example of the number of rate
6 cells that are appropriate when you are doing a rate in the
7 small group and regulated insurance market.

8 So this slide shows two sets of factors. They are
9 six-tier and four-tier factors that take two demographic
10 factors into account. Down the left-hand side you see "Age"
11 and there are 10 categories and across the top are six,
12 "Family status, employee, employee plus spouse, employee
13 with children," so six types of families, 10 types of ages.
14 So there are 60 rate cells on one and 40 on the other. So
15 there are a hundred rate cells on this chart.

16 In addition to this page, there is also area factors and
17 benefit plan relative factors. So literally there are
18 thousands of rate cells when you do a rate. And I'm going
19 to call them a thousand rate cells, for lack of a better
20 term, to talk about the complexity of doing rates in the
21 State of Washington.

22 A lot of the testimony that was given starts out let's
23 suppose the rate in Eastern Washington is fill in the blank.
24 And the problem with that is there is not one rate that
25 Premera charges in Eastern Washington and one rate that they

1 charge in Western Washington. So you could take a simple
2 example and compare it and say, oh, they are doing or not
3 doing what these economic assurances propose that they would
4 or would not.

5 So it is not a simple rate. And so the problem is OIC
6 review - not the problem - the solution is OIC reviews and
7 ensures that development of these rates will be consistent
8 over time including the development of rates by an
9 individual health plan such as Premera.

10 So the OIC's job is to do these reviews. And the
11 assurances that the Washington consulting - Washington
12 consultants are suggesting is that they speak to a specific
13 time horizon. We think it should be at least three years.

14 The problem with having them only two years, first of
15 all, what has been the rating practices? Well, the current
16 rating practices of Premera, as I understand them, have been
17 relatively the same since the MSC merger. And they have
18 been consistently the same as Premera, through its
19 Dimensions product, and its major competitors have retooled.

20 So there has been a lot of talk if we have those
21 assurances for a longer period of time, they are
22 constrained. Well, there has a lot been going on over the
23 last years that haven't caused them to change area rating
24 practices. So although we acknowledge that they are
25 consistent and said they would continue to be consistent, it

1 was only a two-year horizon. Because of the way the
2 healthcare is monitored and the time it takes for experience
3 to develop, you need at least 18 months to check that
4 experience has been gathered and it is credible and you file
5 a new rate filing for the OIC to even check that they are
6 following the assurances.

7 So if they are only two years long, you can't even use
8 them to evaluate whether Premera followed them in the time
9 frame you set them up for. So they need to be longer. We
10 are suggesting at least three years.

11 And there has been some conversation that Premera
12 doesn't intend to do anything different. And although I
13 believe the person that is saying that, people change.
14 Premera is not a person. It is a board of directors. It is
15 a lot of people and there could be different people,
16 different facts and circumstances.

17 So although Premera has asserted we are going to do
18 things the same, having a longer time frame would allow the
19 OIC and its staff actuaries to, in fact, evaluate that
20 Premera is following the assertions that Ms. Halvorson and
21 Mr. Lusk have testified that they would, in fact, follow.

22 Q Okay.

23 MR. HAMJE: At this time, the OIC staff would offer
24 S-69 into evidence.

25 MR. KELLY: I have no objection.

1 MS. HAMBURGER: No objection.

2 MS. McCULLOUGH: No objection.

3 JUDGE FINKLE: Admitted.

4 Q (BY MR. HAMJE) Mr. Staehlin, I wanted you now to focus -
5 again, we are still talking about the economic assurances.
6 You mentioned the constraints of revenue neutrality. What
7 are your comments relating specifically to that issue?

8 A Well, there has been a lot of conversation about that. And
9 that is an application in Washington regulation that affects
10 use of current demographic factors and existing product
11 portfolio and says if you file rates in community rating,
12 you have to do a revenue projection. And in that regard if
13 one rate goes up, the other rate is going to go down.

14 However, as I said, current demographic factors and
15 existing product portfolio, there are situations that exist
16 when you can make substitutions and changes that would
17 effectively - effectively default to actuarial judgment in
18 making adjustments to these rates.

19 And I refer back to the thousand rate cells and I want
20 to talk about a change in stop-loss coverage that could
21 effectively totally retier your age factors.

22 Q And, at this point, Mr. Staehlin, have you prepared a slide
23 that illustrates your discussion?

24 A Yes, I have.

25 MR. HAMJE: And, for the record, I would say that

1 the next slide is S-116 and, of course, this is - this is
2 not one that has confidential proprietary, so it is exactly
3 - what we show will be exactly what is in the record that
4 has been submitted.

5 Q (BY MR. HAMJE) So if you would go ahead and discuss that
6 slide, please.

7 A Okay. I have to do a little bit of framing, so I'm going to
8 look at my copy that is over here, but you will be able to
9 see it.

10 What this is is it is a graph that graphically shows age
11 factors. And as we saw on the first rating sheet, they
12 actually had 10 age factors, but just for ease of experience
13 what I have shown here is generally the employee age factors
14 for rating health insurance. And when you do rates, you
15 have to fund those rates. And stop-loss coverage
16 effectively changes the way they are funded.

17 When Premera charges an employer a premium, they are
18 essentially charged for their experience under the stop-loss
19 level, charged directly generally. It could be as a pool,
20 but they are charged. The experience above the stop-loss
21 level is an insurance rating mechanism to keep rates stable
22 for the population.

23 So the Blue age - the Blue factor here is - suppose your
24 stop-loss level was \$100,000, now, the red is suppose your
25 stop-loss level was \$10,000. I'm not proposing that Premera

1 is suggesting to change their stop-loss level from \$100,000
2 to \$10,000. I'm proposing this is an example of a way that
3 you could change the way you rate healthcare coverage to
4 effectively change all your age factors.

5 I'm sure you'd get a lot of discussion from your
6 marketing people as to why you are doing this. The point is
7 you could make a change such as this and change all of your
8 age factors.

9 Now, as you are looking forward, you have now changed a
10 significant proportion of your demographic assumptions. If
11 coupled with that, you have changed your product portfolio
12 in at least a small way, but significant enough so you had
13 the ability to use actuarial judgment to say I don't have to
14 use my existing pool of coverage to define the rates because
15 it is slightly different.

16 Dimensions might be an example or historically when
17 people change from HMO setting - from HMO to POS. And so
18 the product was enough different that essentially the
19 product portfolio was changed. And so if you changed your
20 stop-loss coverage to change your age factors at the same
21 time that you change your product portfolio, virtually all
22 the thousand rates would change.

23 So revenue neutrality would not come into play because
24 now I have new demographic assumptions and I have new
25 product portfolio. So this is another example - I have

1 offered some that led to the economic assurances, but this
2 is another example of ways the rates can be changed.

3 Have I figured out how this could change rates in
4 Eastern or Western Washington? No. What I'm suggesting is
5 rates are complex and there is actuarial judgment involved
6 that is not defeated by revenue neutrality. So if you don't
7 extend it for three years, the OIC staff is really impaired
8 in checking that Premera is following exactly what they have
9 asserted that they intend to do. And that's the reason I
10 think that economic assurances need to be for a longer time,
11 at least three years.

12 MR. HAMJE: At this time, Staff would offer S-116
13 into evidence.

14 MR. KELLY: No objection.

15 MS. HAMBURGER: No objection.

16 MS. McCULLOUGH: No objection.

17 JUDGE FINKLE: Admitted.

18 Q (BY MR. HAMJE) Mr. Staehlin, do you have any comments,
19 aside from those, with respect to the economic assurances
20 itself?

21 A Yes, I do.

22 Q Would you focus now, then, on any observations or comments
23 you have with respect to the accuracy of projections and the
24 analytics?

25 A The issue here is this affects, to some degree, the analysis

1 that we have done in the economic impact, but to a larger
2 extent the share allocation. You could put this slide down.
3 It is not necessary.

4 That it is very important for - for people doing
5 analysis to have accurate projections because the analytics
6 that follow are based on the projections, so it is very
7 important to have questions answered and accurate
8 projections.

9 I'm referring to Premera's hearing brief and I would
10 like to talk about Page 4 of that hearing brief. I'm not -
11 I don't know if you want to look at those two quotes, but
12 I'm go read those two quotes into the record as I talk.

13 Q Would you cite the line number, please?

14 A So Page 4 of Premera's hearing brief and . . .

15 Q Please proceed, Mr. Staehlin.

16 A Okay. The first quote is on Line 12 and it says, "The best
17 way for Premera to obtain additional capital is to raise it
18 through the equity markets."

19 And the second quote is on the same page, Lines 23 to
20 25. And I think the lines may be a little off-center. But
21 this is the quote: "Rating margins in the current Premera
22 premium rate projections are generally not sufficient to
23 meaningfully increase Premera's surplus in relation to its
24 RBC benchmarks."

25 Now, those quotes are important because at least one

1 major product line of Premera, ASC, is currently priced to
2 only cover marginal expense.

3 Q And, Mr. Staehlin, would you please tell the Commissioner
4 what you mean by "ASC"?

5 A That is administrative service contracts, also called ASO,
6 where there is little risk for claims and you are just
7 pricing expenses.

8 Q And so please proceed.

9 A So marginal pricing may take advantage of excess capacity or
10 operating efficiencies for a short period of time. But
11 Premera's main growth from 2002 to 2007 is in the ASC
12 product line and so it requires a focused evaluation of how
13 they are doing in each of their main product lines.

14 So without more precise responses that were asked of the
15 determining agent regarding financial projections and
16 allocation of expenses, I think it is less certain that the
17 best way to obtain additional capital is through the equity
18 market. And it is uncertain of how rating margins might
19 improve, be expected to improve the surplus if Premera were
20 a more efficient healthcare provider meaning a lower in
21 expense per member.

22 Q Mr. Staehlin, now, I think I would like to ask you, then, to
23 focus next on the share allocation question.

24 Have you - have you completed your comments with respect
25 to the other issues that you wanted to talk about today,

1 other than share allocation?

2 A Yes, I have.

3 Q Before we get into it, I wanted to ask him a couple of
4 introductory questions.

5 Mr. Staehlin, were you involved in discussions with your
6 counterpart representing the Alaska Division of Insurance
7 staff, and that is the actuarial firm of Reden & Anders,
8 concerning attempts to reach agreement between the ADI staff
9 and OIC staff concerning share allocation issue?

10 A Yes, I have.

11 Q Do you - do you recall - or are you aware of an agreement
12 that was entered into between the staff of both of the two
13 departments in regard to the confidentiality of those
14 discussions?

15 A Yes, I do.

16 MR. HAMJE: At this time, the Staff would offer into
17 evidence Exhibit S-98, which is a - is the certified copy of
18 the Rule 408 agreement that was entered into between the two
19 state staffs with respect to the discussions that
20 Mr. Staehlin was engaged in.

21 And the reason why we bring this up is because we are
22 limited in terms of what we have agreed to - and obviously
23 it does not bind the Commissioner - but we are limited to
24 some of the specific discussions that went between Reden and
25 Anders and - and Mr. Staehlin.

1 JUDGE FINKLE: Any objection?

2 MR. KELLY: I need to check on this one.

3 He is offering S-98?

4 JUDGE FINKLE: Correct.

5 MR. HAMJE: Yes, S-98. That is a certified copy of
6 the Rule 408 agreement.

7 MR. KELLY: I have no objection.

8 MS. McCULLOUGH: No objection.

9 MS. HAMBURGER: No objection.

10 JUDGE FINKLE: Admitted.

11 Q (BY MR. HAMJE) Mr. Staehlin, then, now that we have gotten
12 that out of the way, I understand that you can speak very
13 freely about your understanding of the - and your comments
14 about this issue, as long as you don't get into the specific
15 discussions with - that occurred between you and Mr. Drannen
16 (phonetic) and other members of Reden & Anders.

17 So would you please tell the Commissioner what your
18 comments are with respect to the share allocation issue?

19 A Well, first I would like to I say what we were asked to do.
20 And we were asked to determine actuarial share value that
21 would accrue to the State of Washington as a result of the
22 conversion of Premera to a for-profit entity.

23 And in doing that work, we understood that there will be
24 shares of New Premera and they will represent 100 percent of
25 the value at conversion. I authored a report that has been

1 entered entitled - well, it is S-24. Its title is,
2 "Actuarial Analysis of the Proposed Conversion of Premera
3 Blue Cross for the State of Washington." And the report
4 analyzed the history - I will say history with quotes around
5 it - from 1945 to 2007, which was the final year of the
6 projections in the original Form A.

7 And based on our analysis, we believe that the State of
8 Washington should receive between 82 and 88 percent of the
9 shares of New Premera and our point recommendation is 85
10 percent, which is the midpoint of that best estimate range.

11 Q Mr. Staehlin, have you had a chance to review the
12 communication that was received from the Alaska Division of
13 Insurance to the Commissioner, which was received in the
14 last few days relating to this issue?

15 A Yes, I have.

16 Q And do you have any comments about it?

17 A Yes, I do.

18 Q Okay.

19 MR. HAMJE: I have a copy. I would like to - my
20 understanding is that all of the parties have previously
21 received a copy of this, but we have had one marked and we
22 would like to introduce it into evidence so that
23 Mr. Staehlin can discuss it. It will be marked - my
24 understanding is S-123 is the next one in line.

25 MR. KELLY: No objection.

1 MS. HAMBURGER: No objection.

2 MS. McCULLOUGH: No objection.

3 JUDGE FINKLE: Admitted.

4 MR. HAMJE: I guess I give the original to --

5 MS. SUREAU: Yes. Thank you, John.

6 MR. HAMJE: You probably already have several copies
7 of it.

8 MS. SUREAU: I could use one. Just one. Thank you,
9 John.

10 JUDGE FINKLE: And one for us.

11 MR. HAMJE: And, Mr. Staehlin, you have one, don't
12 you?

13 THE WITNESS: Yes, I do.

14 Q (BY MR. HAMJE) Would you please share with the Commissioner
15 your comments about this - about this communication?

16 A This is a 34-page report that I saw for the first time
17 yesterday in detail. And I have spent a little bit of time
18 trying to decide how to frame it, because I think my report
19 was about 100 pages long and this is a 34-page response.

20 So I think the best way to talk about it is to step back
21 a step and try to characterize for you what I was asked to
22 do in an object lesson.

23 When I was growing up, I spent Saturdays at my
24 grandmother's for lunch and she had envelopes up in a
25 cupboard where that's the way she budgeted her expenses, so

1 she had so much for food and whatever. And she would write
2 on one of them deposits in there and withdrawals from those.
3 So - and she would share with me that's the way she managed
4 the money and that's where it came to mind.

5 But the way I now turn that in what I was asked to do,
6 instead of envelopes I'm going to use jars. And so we were
7 asked to review the history of Premera as to how much money
8 was in each of those jars. And there would be a jar for
9 Premera Blue Cross of Alaska and Premera Blue Cross of
10 Washington.

11 Now, I'm also going to say instead of having envelopes
12 with writing on it, let's talk about ledgers. When I looked
13 at the OIC, there was some handwritten ink filed documents
14 by Premera back in the old days. And so they called to mind
15 these ledgers of how you keep track of things.

16 And what I propose is the ledger entries would be the
17 operations of the insurance company, premiums go in, claims
18 go out, expenses go out, investment income goes in. There
19 is things such as other income goes in, other expenses go
20 out and since 1997 federal income tax came out.

21 So we have those ledgers and we have the jars. The
22 problem is we don't have two jars, we only have one jar
23 because Premera Blue Cross was not Alaska and Washington.
24 It was Premera Blue Cross and its predecessor companies.

25 So our whole job was to instead of having one jar,

1 create two jars. The problem was the ledgers that we
2 structured by looking into all this data, they had
3 significant holes, significant gaps and significant
4 inconsistencies.

5 So our job was to take a look at all of this data and
6 reconstruct history to come up with how much money was in
7 each jar and that would then be the shares that would be
8 allocated to the states.

9 In doing that job it was quite extensive and I have - a
10 lot of information was gathered. But then we had a process
11 to try and understand it because four different people
12 looked at doing that job and came up with four different
13 answers as are outlined in this report.

14 What I'm going to now confine my comments to is the
15 "Executive Summary," which is Page 3 in the first paragraph
16 of Page 4. So Page 3 and Page 4 of this response - and
17 there are eight - I have numbered the paragraphs - or I have
18 numbered them. There are eight assertions as to how PwC
19 improperly behaved. The word "improperly" is in each one
20 except for Paragraph 5 where it says, "contrary to practice
21 PwC was inappropriate," so I will assume that that is
22 improperly also. So improper behavior in eight areas.

23 However, I want to go back to the ledger example. When
24 you take all of those columns, we basically agree - there is
25 some comments in here about - there is some basic agreements

1 in terms of the way to go through this process. We
2 basically agree on premiums. We basically agree on claims.

3 Now, expenses were actually split into three pieces,
4 commissions, primary tax and other administrative expenses.
5 And the interesting thing about commissions and premium tax
6 is they are related to premium. The percentage is usually
7 of premium. So in the audit opinion that was also filed by
8 PwC, they said that Premera is capable of keeping track of
9 premiums and claims. And so we use that to mean if you
10 could keep track of premiums, you could keep track of
11 percentage of premiums also.

12 So premiums are okay, claims are okay, the commissions
13 are okay, primary taxes are okay, generally other income and
14 other expenses are okay and federal income tax is just a
15 calculation when you are all done.

16 So it leaves two significant areas of - of review and
17 analysis that are required, administrative expenses and
18 investment income, those two items. So if you look at the
19 eight points that Alaska - the Alaska report says that PwC
20 improperly behaved, the first one talks about expense
21 allocations.

22 And the assertion by the Alaska consultants is that PwC
23 changed the expenses in 1997 to 2002 even though actuaries
24 generally do not adjust historical numbers without hard
25 evidence as to why this adjustment is necessary. That is

1 just incorrect, "actuaries generally do not adjust."
2 Actually, the main actuarial job usually is to analyze
3 history in this regard and make appropriate adjustments
4 because what we are trying to do is figure out true value.
5 We are not trying to figure out what Premera or its
6 predecessor companies, what they reported, is that correct
7 or was it illegal or was it inappropriate? The point is
8 does it reflect true value?

9 So, for example, if in 1960 they put it - they took a 10
10 dollar bill out of Washington and a one dollar bill out of
11 Alaska's pot, is that correct? Not is that what they did,
12 but is it correct? Does it reflect the true value of the
13 cost of doing business in Washington and Alaska at that
14 time?

15 So the answer is not let's record what was in Premera's
16 financial statements that - we did obtain the majority of
17 them over the 60 years. The point is let's test how valid
18 is that in measuring costs. And in doing that you have to
19 look not only at the year that the entries were made, you
20 have to look at over time what happened, because also a
21 practice in reporting has changed.

22 It would have been great if the current NAIC standards
23 for reporting had been enforced for all 60 years. They were
24 not. So there are a number of years where there are no
25 expenses split by Alaska or for Washington, so you have to

1 make assumptions about all those years. This comment is
2 taking issue with five years and saying, "Hey, you made
3 adjustments from what was reported."

4 Well, the standard is not what was reported, the
5 standard is what - what was reported reflective of the
6 costs - the cost that it took to administer that business.

7 So we analyzed the data over the entire period, as our
8 report will show, over the 60 years to say that not only is
9 something reported in a year, close or appropriate, but does
10 it require adjustment because it is not reflective of the
11 true costs?

12 And the way I look at it is there is a lot of talk when
13 we look at a health plan of let's restate claims, let's look
14 at the history because each year Premera has to record the
15 claims it paid that year plus an estimate of reserves at the
16 endpoint and that gives you a change in reserve and an
17 incurred claimant. But each year you could also look back
18 and say what was really incurred? And now the statements
19 require you to do that for the past five years, so you see
20 how the reserves were tested out.

21 So it is - it's a lookback of reserves. Well, very few
22 people look back at expenses, but just because they don't
23 doesn't mean I don't need to do that in - excuse me - PwC
24 doesn't in terms of its engagement might be to say is what
25 was recorded reflective of the cost?

1 So it is absolutely appropriate to look at the costs
2 over time and make a judgment as to what is going on from
3 the changes. And we did that and we made appropriate
4 adjustments. That's expenses.

5 Now, I want to also by reference talk about Paragraph 3
6 and Paragraph 6. And it talks about a start-up adjustment.
7 And I did - I was able to look at the report to some degree
8 and it asserts that Mr. Staehlin is treating Alaska and
9 Washington as if it were two different companies and that's
10 inappropriate.

11 And that's not correct. What I'm doing is saying what
12 was the cost of doing business in Washington and Alaska in
13 each of the historic years? And my point here is similar to
14 Premera's move to Arizona in 1953. I think somebody said
15 they actually moved in 1948, but I don't think they wrote
16 any business until 1953.

17 But anyway somewhere in the late '40s to early '50s
18 Premera moved to Alaska. So at that time it was a new
19 division, a start-up, for lack of a better term. But it
20 wasn't a separate company. That's not what I'm asserting.
21 What I'm asserting is what was reported on the statutory
22 statements was like a marginal cost allocation. Well, it
23 costs us a few dollars to administer statements, so we'll do
24 the same thing in Alaska.

25 That's incorrect. Because as you will see in a

1 projection by Arizona - let's say that you developed that
2 the minimal cost of doing business was five million dollars.
3 That's what it costs to have a couple of executives, a good
4 strategy, a building and computer system. So it costs five
5 million dollars. Well, you have a million member lives
6 which is 80,000 over a year, then it is \$5.00. So if you
7 only have 1,000 people when you start, it is \$5,000 a month.

8 Now, I'm not saying Premera should charge those premiums
9 or record them in the way they do filings. What I'm saying
10 is that is the true cost of doing business in that
11 environment.

12 So in Alaska it is totally inappropriate to say until
13 Alaska was big enough to be a stand-alone entity. What do I
14 mean? It is in my report there is a lot of literature about
15 what does it take to be a stand-alone health plan. How many
16 lives do you need?

17 And, again, we probably have four estimates or we may
18 have eight estimates of what that is, but there is general
19 literature you need to be of a certain size to support your
20 costs.

21 So what I have done is taken that literature and said
22 from 1953 to 1973 Alaska was too small to support its own
23 administrative costs. Obviously the adjustment is heavier
24 in the early years and it is less in the later years.

25 In the same regard this item about what is this loan,

1 well, if you look at what capital would have been - the
2 capital needs would have been back then, you would say they
3 needed to take a loan. Now, in the report they said there
4 wasn't any actual loan, why are you doing this calculation.
5 Today the standard is RBC. Everybody has talked at length.
6 RBC is very important. It is the way you have to measure
7 the health plan.

8 But if you apply RBC back then - because the standard
9 now probably wouldn't have been the standard back then. We
10 just hadn't thought of it yet. So RBC is the best standard,
11 so Alaska needed larger expenses and if adjustment, it
12 needed a small loan to keep itself going in that period of
13 time through adjusted data .

14 So it is appropriate to adjust expenses for all of those
15 reasons. That - I'm not saying what Premera recorded - I'm
16 not saying their allocation systems have not been approved
17 as generally appropriate. Are they a reflection of true
18 costs given all the analysis I have done of what they
19 recorded, what they have told me, the data they have given
20 us about their product lines, their rate filings, all of
21 that indicating that the expenses are not appropriate in
22 Washington versus Alaska in 1997 through 2002, in 1953 to
23 1973?

24 As a matter of fact, if you read the report, it says we
25 actually substituted expenses from 1953 to 1978 because we

1 had little record. There was a big hole in the ledgers of
2 administrative expenses. So they were basically required to
3 be developed.

4 So if you would look the back and say why can't you just
5 put them on and make the withdrawals and deposits into those
6 two jars, the administrative expenses - it is a large hole
7 that needs to be filled through the analysis that we have
8 done.

9 Q Mr. Staehlin, I just want to go ahead and just find out now
10 exactly where we are in our comments. You have discussed
11 Bullet Point Number 1; is that correct?

12 A Yes, I have.

13 Q Have you discussed Bullet Point Number 3?

14 A I'm skipping Bullet Point Number 2. It is also expenses,
15 but there is no value attached to it. So in the interest of
16 time, I am skipping over that one. I have discussed 1, 3
17 and 6.

18 JUDGE FINKLE: How much longer do you expect to be
19 on that?

20 MR. HAMJE: Well, I understood it was going to take
21 about 10 minutes all together. Mr. Staehlin, do you have -
22 can you wind it up in about five minutes or so?

23 THE WITNESS: Yes.

24 Q (BY MR. HAMJE) Okay. Would you please, proceed, if you are
25 going to go onto Bullet Point Number 4?

1 A I'm going to talk about investment income, which is another
2 significant issue. The comment that PwC improperly adjusts
3 investment income to 1997 to 2002 by smoothing is - just
4 gives a totally incorrect picture of the way the process was
5 done. PwC adjusted investment income consistently from 1945
6 to 2007 by the method used by Premera, which is that you
7 allocate investment income based on incurred claims.

8 It is the most recognized means to allocate investment
9 income when there is a lack of actual allocation of assets.
10 It would have been better had they allocated assets over
11 time, but they did not. So instead of using premiums, which
12 actually are an estimate of what the claims would be next
13 year or any other measure, the best way to do it is to
14 adjust it based on incurred price because that's actually
15 what is paid.

16 And over time, over the history of Premera, both
17 Washington and Alaska have relatively similar underwriting
18 gain loss over the whole period. Yes, there have been
19 periods where each of them have lost significant money due
20 to the operation of the health care trend and estimate
21 thereof, but over time, their underwriting income is
22 approximately the same.

23 So the best way to do it, lacking the actual allocation
24 of assets is to base it on incurred claims. That's what we
25 did consistently because, as had been mentioned, Alaska

1 happened to be making good underwriting gains recently.

2 Alaska, on the other hand, switched to "Well, we need to be
3 getting some recognition of this, so we are going to shift
4 our allocation so it brings cash flow into account." The
5 interesting about that is we all know what was going on in
6 the investment market between 1999 and 2002, when they had
7 more cash, their investment dashed and they went backwards.

8 So the point is the most consistent way to do it is to
9 pick a method and follow it through the process. That's
10 what we did. And we feel it recognizes investment income
11 correctly.

12 The last point - and in the interest of time, I just
13 want to characterize the future value of the business where
14 - we were much closer on the historic value, but on the
15 future value, the Alaska team asserts that contrary to
16 actual practice, PwC did not follow the ASOP-19.

17 In my view, the - the Alaska team has misinterpreted
18 ASOP-19. And it - there are a number of reasons that I
19 think - for lack of time, again, I will fill out in our
20 response, but that the method they have used is - is not
21 required by ASOP-19.

22 And so there is a big disconnect on future value and how
23 that ought to be regarded and a big disconnect from why
24 historically it is one number and why on a future value it
25 is based on something totally different.

1 There are other factors in here about what is the right
2 projection to use. That was not detailed in our report. It
3 will be in our response. But the basic response is that in
4 all regards, with the exception of the last factor, which I
5 will just say, Paragraph Number 8 on Page 34, it - it is the
6 assertion that Alaska is too small. And it is kind of like
7 two people come to the table and one person says, "Well, you
8 can only come to the table because of me."

9 I understand that the reaction to that would be adverse
10 from the Alaska side and the size of that adjustment might
11 be open for discussion. However, on one side, I believe the
12 State of Alaska would like some assurances that if something
13 bad were to happen and they went down to 375 percent that
14 somebody would back them up. And now, to me, that's an
15 assertion that you are too small.

16 So in this regard they are talking out of both sides of
17 their mouth saying, "Well, we need that assurance because
18 something could happen, but by the way, we were big enough
19 to go out on our own." So we have added a factor for that
20 concern that could be open to discussion, whether it is zero
21 to two points, somewhere in that range.

22 So with that, in the interest of time, I think I will
23 cut short the conference.

24 Q I just have one thing that is for clarification. You talked
25 about an ASOP-19. What is that?

1 A There are actuarial standards of practice for use in doing
2 actuarial engagements, which PwC considers the share
3 allocation to be. They are in the 40s - 40-some of them.
4 And the ASOP-19 is one of the actuarial standards of
5 practice quoted in the Alaska report.

6 Q And which bullet point are you referring to?

7 A Number 5.

8 Q Okay.

9 MR. HAMJE: That's all I have.

10 JUDGE FINKLE: Okay. Let's take a break.

11 MS. McCULLOUGH: Your Honor, before we take a break
12 I just want to request that any comments that the OIC staff
13 submits on the 25th be confined to anything that is in
14 addition to what Mr. Staehlin just testified to.

15 MR. HAMJE: I'm sorry. I didn't understand.

16 JUDGE FINKLE: Maybe you could repeat that.

17 MS. McCULLOUGH: I just want to make sure that
18 anything that they will be filing that is in response to
19 this submission from Director Hall (phonetic) is simply in
20 addition to what Mr. Staehlin has just testified to, that
21 they are not given an opportunity for double testimony.

22 MR. HAMJE: We do not agree to that. We are going
23 to want to have a complete response in writing.

24 JUDGE FINKLE: Right. There has been a very limited
25 opportunity to react to this report and my intent in setting

1 the deadline was to permit all parties to make as full a
2 response as they wish. And the intent in having a gap
3 between that and the final submissions was to permit a
4 response to that additional material. So I'm not going to
5 impose that limitation.

6 Let's take a break.

7 MR. HAMJE: Thank you.

8
9 (Brief recess.)

10
11 JUDGE FINKLE: Let's proceed.

12 MR. KELLY: Thank you.

13
14 CROSS-EXAMINATION

15
16 BY MR. KELLY:

17 Q Good afternoon, Mr. Staehlin.

18 A Good afternoon.

19 Q I would like to start with just a couple of questions I have
20 on allocation so I don't forget to ask them.

21 The first one is it sounds to me - well, let me ask you
22 this: Premera's capital was, in 1989, 43 million dollars;
23 is that about right?

24 A I would have to look at the report.

25 Q But it was in that neighborhood?

1 A If you say so, I will believe it.

2 Q In 2003, what was its capital?

3 A Let's see. I believe 2002 was about 315. I don't know
4 what 2003 was, but because they made money it would be
5 higher.

6 Q Okay. I guess I'm wondering, you spent your time in
7 preparing this report analyzing the periods from 1945 to
8 1989, which is a 44-year period. I'm sure that took a lot
9 of time, but that really involves less than probably around
10 10 percent of the capital.

11 A No, we went all the way to 2007. I don't know what the
12 1989 --

13 Q Well, 1989 I was using as a benchmark where Premera only had
14 10 percent, say, of the capital it has now. So you did a
15 historical review backwards for 10 percent of the capital
16 because you started in 1989 and covered 90 percent of the
17 capital. Does that make sense?

18 A You can't take a point in time and know what the proper all-
19 - just because it is a small amount of the total. It could
20 have been disproportionately produced by one of the parties
21 who is entitled to a share.

22 Q Don't most valuations look forward for a value?

23 A Most valuations?

24 Q Yeah, in trying to value and anticipate what the value is
25 now and in the future?

1 A Valuation for what?

2 Q Well, for the purpose that you entered into for this
3 valuation report, isn't that what you were doing?

4 A No. I believe most valuations attempt to replace the
5 accumulated capital with the appropriate number from the
6 beginning of time forward.

7 Q Okay. Now, do you remember being asked - I think it is by
8 Ms. McCullough - in your deposition back in March as to why
9 you didn't use the cost of capital in your evaluation? Do
10 you remember that?

11 A I remember being asked about that, yes.

12 Q Okay. Do you remember giving the following answer, quote,
13 "Because Premera has not had any free capital - essentially
14 that's a value judgment on my part - but they have struggled
15 to be a 375 - at 375 percent of the group Blue Cross
16 Association standard. So they haven't had any free capital,
17 and subject to the projections, do not currently have a lot
18 of free capital and I judged it not significant in this time
19 horizon."

20 MS. MCCULLOUGH: Your Honor, may I interrupt just
21 for a moment? Can you refer us to what page?

22 MR. KELLY: Page 184.

23 JUDGE FINKLE: Wait just a minute.

24 MR. HAMJE: May I ask which session that was, which
25 date?

1 MR. KELLY: Sure. I think it was the March session
2 because that's when we discussed the allocation.

3 MS. McCULLOUGH: It was March 5th, right?

4 MR. KELLY: (Nods head.)

5 All set?

6 MS. McCULLOUGH: Yeah. Thank you.

7 Q (BY MR. KELLY) That's what you said?

8 A Yeah. It was interrupted in the middle, but you were
9 reading from my deposition, so, yes, I recall that
10 testimony.

11 Q And basically you were saying that Premera, in your view,
12 struggled to be at 375 of the standard and didn't really
13 have any free capital and so you didn't even evaluate it for
14 purposes of your evaluation; is that correct?

15 A That was one of the factors and the comments about that -
16 that portion of the valuation, yes.

17 Q Very good. Thank you.

18 Okay. Now, let's take a look for a minute - or talk for
19 a minute about either Exhibit 1 - Exhibit S-69 or your
20 slide, which you don't need to put up again - well, actually
21 can that easily be put up again?

22 A Which one, 69 or 116?

23 Q Well, let's - I don't want to spend too much time on this.

24 Let's just go with the slide. No, the other slide. Good.

25 Okay.

1 Now, this is a normal rate filing that OIC staff sees
2 every day; is that correct?

3 A I don't know if they see it every day, but they see a number
4 of rate filings.

5 Q And this is part of major activity in the Office of the
6 Insurance Commissioner to review these; correct?

7 A That's correct.

8 Q Now, there are legislative limitations, are there not, in
9 how much change can be made, for example, in the age scope
10 or for any of those columns? In other words, the - the
11 high-low ratio has a legislative limitation, does it not?

12 A Yes, it does.

13 Q Okay. And there is also a limit in the number of ranges of
14 age, there can be no more than five in variation; is that
15 correct?

16 A I can't speak to that at the present time.

17 Q You don't know what the regulation is?

18 A No, this has ten, but if you are telling me it is five, I'm
19 not aware of that.

20 Q What I'm saying is 55 to 59, 60 to 65.

21 A Oh, the age ratio.

22 Q Right. Yes.

23 A Yes.

24 Q Do you know if that is part of the regulations in
25 Washington or not?

1 A Not off the top of my head right now, no.

2 Q Okay. And underneath, for example, going from one column to
3 another, between "Employee" and "Employee plus spouse," the
4 OIC has issued interpretive guidelines that limit how much
5 changes can be made between those two as well; isn't that
6 the case?

7 A That's my understanding.

8 Q Okay. Let's turn to the other slide for a minute and that's
9 the one with the stop-loss. And this is an example that you
10 gave of what could happen; is that correct?

11 A That is an example of a way to change one's age factors
12 scale, yes.

13 Q Now, you are a not aware of Premera ever doing this, are
14 you?

15 A I am not.

16 Q Okay. Are you aware that Premera does not use any stop-loss
17 for individual and small group?

18 A They might not use a stop-loss carrier, they still could use
19 an internal stop-loss mechanism.

20 Q Right. My question to you is are you aware that Premera
21 does not use any stop-loss for individual and small group or
22 are you not aware of that?

23 A No, that's my understanding.

24 Q Your understanding is that they do not?

25 A They do not, yes. They want to - they don't re-insure that

1 risk to another party.

2 Q And was it also your understanding that they don't do it
3 internally either? Is that case?

4 A No, I'm not aware of the interaction exactly between Premera
5 Blue Cross and - they have one subsidiary that has a
6 stop-loss coverage for some of their lines of business.

7 Q My question is this: Before you took this example, did you
8 check with Premera to see whether it applied to their
9 situation or not? It sounds like you didn't?

10 A It is an example of how one could change what they are
11 doing, whatever their situation is today.

12 Q Right.

13 A They could do something different tomorrow.

14 Q But if they are not currently doing it as part of their
15 business plan, there is no particular reason to think that
16 they are suddenly going to engage in stop-loss --

17 MS. McCULLOUGH: Objection. Argumentative.

18 MR. KELLY: This is not argumentative. This is
19 probing for cross-examination.

20 JUDGE FINKLE: Overruled.

21 Q (BY MR. KELLY) You can answer.

22 A It is an example of a way that someone could approach the
23 way they do their rating.

24 Q And they could go into a variety of other businesses, right?
25 They could go into the Hamburger business, but there is no

1 basis or reason to think that Premera is going to go into
2 that other business, so my question to you is there is no
3 basis or reason for you to think that Premera is going to
4 start using stop-loss if it doesn't use it now, is there?

5 A There is no basis for me to think they are going to start
6 using stop-loss?

7 My point is the assurances are needed, so they do not -
8 whatever their intention is today. That intention could
9 change.

10 Q You are not listening. Please just listen to my question
11 and answer. There is no basis or reason that you have to
12 think that Premera is going to change its business plan and
13 strategy to start using a stop-loss mechanism if it doesn't
14 do it now; isn't that true?

15 A That's true.

16 Q Okay. Now - and you chose for an example to present to the
17 Commissioner stop-loss issues when, from what I understand,
18 you knew that Premera did not utilize stop-loss; isn't that
19 true?

20 A I did not use that knowing that they - no. My answer to
21 that is no.

22 Q Well, then you knew that Premera did use - didn't use
23 stop-loss, but you decided anyhow to present it as an
24 example to the Commissioner; is that what you are telling
25 us?

1 A What I said is they have stop-loss that goes from Premera to
2 one of their subsidiary companies. At least I think in the
3 ASC line, it is my recollection there is some stop-loss to
4 one of their subsidiary companies.

5 Q I guess I'm wondering - well, I will withdraw the question.
6 That's fine.

7 Conversion does not impact OIC review in any way, does
8 it?

9 A I'm sorry. Say that again.

10 Q Conversion does not impact OIC review? It is - the OIC
11 review function is not going to be changed in any way merely
12 becomes Premera converts; isn't that true?

13 A That's true.

14 Q Okay. And from what I'm hearing you say, there are things
15 that you think Premera could do and that's why you think
16 there ought to be a longer assurance period; is that it in
17 sum and substance?

18 A That is it in sum and substance.

19 Q Okay. So all of these concerns that you have are
20 theoretical concerns about what Premera could do; is that
21 correct?

22 A Could you say more about why you are saying they are
23 theoretical?

24 Q Because there is no bases in fact, they are just something
25 that could happen?

1 A They are something that could happen, yes.

2 Q Okay. Good.

3 Let's talk a little bit about constraints on Premera.

4 You would agree, would you not, that there is a regulatory
5 requirement that total revenue will remain the same with or
6 without the area factors; is that correct?

7 A Yes.

8 Q Okay. And that's the revenue neutrality requirement;
9 correct?

10 A Imposed on existing products with current demographic
11 factors, yes.

12 Q Okay. But - and also adjusted community rating requirements
13 require Premera to adjust its area factors to reflect
14 changes in expected medical costs and Premera uses such
15 factors; is that correct?

16 A Yes, they do.

17 Q And one of the requirements for Premera and for all
18 insurance companies is that they have to actually look at
19 the actual claims experience that they have had for all
20 products in any particular group; is that correct?

21 A Unless there is a significant enough shift that you would
22 say actuarial judgment would change the credibility or bring
23 in outside experience that is appropriate to the analysis.

24 Q Well, if they are talking about small group for any small
25 group product that Premera as a company provides or is going

1 to provide, a new one, it has to go back to its experience
2 in regards to claims or losses for all of its small group
3 products; isn't that correct?

4 A It is not as prescriptive as you are describing.

5 Q It can carve out a portion of its small group experience and
6 still comply with the regulations; is that your testimony?

7 A What I just talked about was the way to change the products
8 that you have going forward so that you only use portions of
9 your existing experience to scale the experience. That's
10 what I just said.

11 Q So I just want to understand. So you think there is a way
12 to make an exception to the claims experience for small
13 groups by creating another small group product that has
14 different benefits and that helps you escape from the
15 regulations; is that your testimony?

16 And please answer the question "yes" or "no."

17 A I don't think it is a "yes" or "no" answer that would
18 describe my opinions in this matter.

19 Q Well, I'm asking - I think is a pretty straightforward
20 question. You are making an assertion that you can create a
21 new product in small group, for example, ignore the claims
22 experience and somehow claim actuarial judgment?

23 MS. McCULLOUGH: Objection. This is argumentative.

24 MR. KELLY: No, it is not.

25 JUDGE FINKLE: Sustained.

1 Q (BY MR. KELLY) Is it your conclusion that you can create a
2 new product for small group and not have to take into
3 account what Premera's experience as a company was in regard
4 to small group liabilities?

5 A You take it into - into effect in some regard, but - you
6 don't ignore it. It is considered.

7 Q It is considered because it is the basis upon which you have
8 to base your claims experience; isn't it?

9 A Or explain how you are using actuarial judgment to
10 distinguish differences.

11 Q But the claims experience is what it is. It's what has
12 happened to all those people who are in this small group
13 over a period of time --

14 MS. HAMBURGER: Objection. Argumentative.

15 Q (BY MR. KELLY) -- isn't that true?

16 JUDGE FINKLE: Overruled.

17 A The claims experience for consistent demographic factors and
18 existing product portfolio would be used for those products
19 under those factors.

20 Q (BY MR. KELLY) Well, it sounds to me like you have
21 interpretation of insurance law where the exception swallows
22 the rule.

23 MS. HAMBURGER: Objection.

24 JUDGE FINKLE: Sustained.

25 Q (BY MR. KELLY) Let's turn for a moment to the ASC issue

1 that you were talking about.

2 Now, you remember that you made the statement that
3 Premera is setting the market or setting the rate for ASC?
4 Did I hear that correctly, or not?

5 A I don't remember saying that.

6 Q Setting the price for the ASC product? Determining the
7 price?

8 A I think I was talking about the way they estimate the
9 administrative costs that they should attempt to charge to
10 their ASC customers.

11 Q And how is that? How do they administrate it in 25 words or
12 less? How do they estimate that in 25 words or less?

13 MS. HAMBURGER: Objection.

14 JUDGE FINKLE: How about allowing him to select the
15 number of words?

16 MR. KELLY: Sure.

17 A They allocate appropriate costs to that line of business,
18 see what that cost is and then see if the market will bear
19 that cost and how they should adjust full costs or marginal
20 costs. We talked about that is their approach.

21 Q Isn't it, in fact, the case that it's a competitive market
22 and that they either - they bid at a price and they either
23 get it from the company or they don't, from the customer -
24 or they don't get it? It is too high or too low?

25 A There is significant negotiation. There is broker

1 involvement. It is much more complicated than just
2 declaring a price and accepting or rejecting.

3 Q Okay. Were you here when Mr. Marquardt explained the
4 approach that Premera is taking and why he thinks that it is
5 wise and prudent for it to be in this business and that it
6 thinks it can eventually make a profit?

7 A Yes.

8 Q And were you hear when Mr. Koplovitz explained why that was
9 an appropriate approach for Premera to do, in his view?

10 A Yes.

11 Q Are you disagreeing with Mr. Koplovitz on that issue?

12 A No, I am not.

13 Q Now, you do understand that ASC growth in the recent period
14 is the result of the addition of one large account, the
15 Microsoft account?

16 A Yes, that's a predominant factor.

17 Q Okay. But overall, the ASC account is a small part of
18 Premera, is it not?

19 A Currently, I believe - small you would have to define, but
20 it is a line of coverage that is not a significant part of
21 their business.

22 Q All right. And you are not suggesting that they are
23 claiming that it is necessarily going to be a significant
24 part of their business in the future, are you?

25 A No, I'm not.

1 Q Okay. Let's go back to - oh.

2 Now, let's go back to this discussion about small groups
3 and determination of rates. In the small group market, if
4 rates were to go up in Eastern Washington and remain the
5 same in Western Washington and go up on an average overall,
6 that would result in a - would require reconfiguration of
7 Premera's geographic factors in both Eastern and Western
8 Washington; isn't that true?

9 A I think so.

10 Q Okay. Doesn't the OIC require that any changes in rating
11 factors, such as the geographic factor, be based on
12 objective data and supported by a large study?

13 A I think it is up to the OIC to define objective data, but
14 generally, yes.

15 Q And don't they also require a large study?

16 A Yes.

17 Q Okay. And if provider payments or health costs - healthcare
18 costs were to go up in Eastern Washington, wouldn't provider
19 reimbursements go down?

20 A Could you repeat that, please?

21 Q If provider payments or healthcare costs go up in Eastern
22 Washington, wouldn't provider reimbursements - I'm sorry.
23 Excuse me.

24 Does the PwC report suggest that provider payments or
25 healthcare costs will go up in Eastern Washington as a

1 result of the conversion?

2 A I'm sorry. Say that one more time.

3 Q Yes. Does the PwC report suggest that provider payments or
4 healthcare costs will go up in Eastern Washington or could
5 go up in Eastern Washington as a result of the conversion?

6 A Do you have a specific reference? I'm not remembering that.
7 It could be in the report.

8 Q Okay. Well, I take it it doesn't. I mean, does it or does
9 it not, do you know?

10 A I don't know off the top of my head right now. If you had a
11 reference, I could respond to it.

12 Q Well, I don't have a reference, but you wrote the report.
13 I'm just wondering, do you recall that the report claimed,
14 if anything, provider reimbursements are going to go down?

15 A It may have suggested that. I didn't write the chapter
16 about provider reimbursements.

17 Q Now, doesn't it follow that the data used to create
18 geographic factors would not result in Eastern Washington
19 geographic factors going up relative to Western Washington,
20 but, if anything, just the opposite would result, that is
21 geographic factors should go down in Eastern Washington and
22 up in Western Washington?

23 A It sounds like a complicated example to me and I don't think
24 I am prepared to answer that at the present time.

25 Q Okay. Doesn't Dr. Leffler suggest that well, if that's the

1 case, that if geographic factors result in Eastern
2 Washington geographic factors going up relative to Western
3 Washington, isn't that just the opposite of what is stated
4 in your report?

5 MR. HAMJE: Objection. Vague.

6 JUDGE FINKLE: I don't understand the question.

7 MR. KELLY: Right. Okay.

8 Q (BY MR. KELLY) Now, the OIC - I guess you are suggesting
9 that you think that Premera would have an opportunity under
10 your analysis to somehow fudge or change or unlawfully alter
11 the cells that you are talking about, in other words, rates,
12 in a way that is not in compliance with the law; isn't that
13 really what you are suggesting?

14 A No.

15 Q That they would consistently have actuarial judgment that
16 happens to lead to them having an increase in rates and an
17 increase in profit; is that what you are suggesting?

18 A I'm suggesting that whoever filed the rate filing would
19 follow the standards of actuarial practice, appropriately
20 file it, and the OIC would evaluate it.

21 Q Okay. So there is no reason to think that there is going to
22 be an distortion or any effort by Premera to inappropriately
23 do its own actuarial analysis before it does the rate
24 filing?

25 A I agree with that.

1 Q Okay. So but you are saying, well, it hasn't happened, you
2 don't think there is any reason that it is going to happen,
3 but it could happen; is that what you are saying?

4 A Yes. Based on the discussions of market power and the
5 entire report, the assurances are there just to ensure that
6 the market stays consistent.

7 Q Right. But you have been talking about a concern that
8 somehow Premera is going to cheat; isn't that really what
9 you are saying?

10 A No.

11 Q No, you are not? Okay. That's good to hear.

12 So they haven't used it in the past or done what you
13 think could be done. You have no reason to think they are
14 going to do it in the future --

15 MS. HAMBURGER: Objection. This is argumentative
16 and repetitive.

17 MR. KELLY: I'm trying to summarize what his
18 position is.

19 JUDGE FINKLE: Go ahead.

20 Q (BY MR. KELLY) Hasn't done that in the past, no reason to
21 think it is going to be done in the future, but you are just
22 worried that maybe something could happen sometime; isn't
23 that a fair summary?

24 A No, it's not worried. It is trying to put in assurances
25 that will be able to be monitored so that Premera does what

1 they say they intend to do.

2 Q Now that you have figured this out in, I guess, relatively
3 short order as some possibility and you have now
4 communicated to it to world, including the OIC staff, don't
5 you think that they would be able, on their own as part of
6 their normal regulatory authority, to do this - do any
7 investigations that are needed without having an additional
8 requirement or assurance added on top?

9 A I think you will have to ask the OIC staff if they feel that
10 is their position.

11 Q The OIC always has the ability to monitor rates for
12 individuals, does it not?

13 A Yes, it does.

14 Q Okay. And they could do a limited scope examination and
15 then if there is a violation, there could be sanctions for
16 such a violation; isn't that true?

17 A My understanding is that those are available to them.

18 Q Okay. And if this were to be done, even though there is no
19 reason to think it would be done, wouldn't it have a
20 potential disastrous consequence for Premera if it turned
21 out that they were inappropriately doing these ratings and
22 it came to light eventually? Even if it didn't come to
23 light within the two years, wouldn't that be harmful to the
24 company? I think I can see the headlines if we were to do
25 that.

1 So what is the - let me ask that question. Wouldn't it
2 be harmful to the company to do what you are saying could
3 theoretically be done with or without the assurances?

4 A Can you ask the question again, please?

5 Q Yes. Wouldn't it be harmful to the company as a business to
6 do what you say could be done with or without the assurances
7 because eventually the OIC staff would catch up with Premera
8 and it would be exposed for its wrongdoing?

9 A Not exactly, because some of the assurances have to do
10 with - with broker compensation and provider access, so it
11 is not just - it is not just the benefit plan relativity
12 factors that we are talking about.

13 Q Right. But you were not testifying at all about broker
14 assurances or relativity factors, you are talking about
15 these changes in the rates; isn't that true?

16 A No. I'm talking about all of them need to be there for
17 three years.

18 MR. KELLY: Excuse me for a minute.

19 I have no further questions. Thank you, sir.

20 MS. HAMBURGER: I just have a few questions.

21

22 CROSS-EXAMINATION

23

24 BY MS. HAMBURGER:

25 Q The PwC report states the assurances should be in place

1 three years or longer; is that right?

2 A That's correct.

3 Q So the assurances mitigate the problem, but they don't
4 eliminate it?

5 A That's correct.

6 Q And the duration of time just stretches out the period of
7 time that that problem is mitigated?

8 A Well, yes. But to the extent Premera follows those
9 assurances, they, in fact, would be shown that they are
10 following what they said they would do.

11 Q Other assurances could be constructed that are based upon -
12 that wouldn't be based upon time passage, but based upon
13 changes in the marketplace; isn't that right?

14 MR. KELLY: Object. This is leading by a counsel,
15 who I submit, is allied in her position in opposition to
16 Premera.

17 JUDGE FINKLE: Sustained. You are essentially, in
18 my view, agreeing and elaborating on his conclusions and
19 therefore --

20 MS. HAMBURGER: No, I actually - we don't agree with
21 the conclusions. We don't think they go far enough and
22 that's what we are trying to elicit here.

23 JUDGE FINKLE: Okay. Continue. Objection is
24 overruled.

25 THE WITNESS: Could you ask the question again,

1 please?

2 Q (BY MS. HAMBURGER) The assurances could be based not only
3 on the exhaustion of the particular time frame but based
4 upon a change in the marketplace, isn't that right?

5 A Could you give me an example? I don't think I understand
6 the question.

7 Q So the assurances that we have, the economic assurances, you
8 say should last three years or longer?

9 A Yes.

10 Q Economic assurances could be constructed to be in place to
11 last until - rather than a time period, but to last until
12 Premera does not have market power? That could be a
13 different way of framing the economic assurances; is that
14 right?

15 A Are you asking me for a hypothetical example?

16 Q For instance, the rate setting assurances could be in place
17 until there was a demonstration that Premera does not have
18 market power in the 14 counties identified by Dr. Leffler.

19 A That could be a proposal, I guess.

20 MS. HAMBURGER: Thank you.

21

22 CROSS-EXAMINATION

23

24 BY MS. McCULLOUGH:

25 Q Mr. Staehlin, I'm Amy McCullough and I'm here on behalf of

1 the Alaska Intervenors. And as you can probably guess, I'm
2 going to be asking you some questions about your allocation
3 report.

4 A Okay.

5 Q As I understand it, your overall approach to the allocation
6 analysis was a combination of historic contribution, future
7 contribution and something you deemed additional
8 considerations; is that right?

9 A That's a fair characterization.

10 Q Okay. And of the total range that you have recommended,
11 which was, as I understand it, 82 to 88 percent for
12 Washington, how much of that accounts for the - I'm sorry -
13 how much of that accounts for these additional
14 considerations?

15 A What is the - I'm sorry. Could you repeat that?

16 Q What part of the total - I'm sorry. Let me be more clear.
17 What part - what portion of the total range do these
18 additional considerations constitute?

19 A I believe the base range was 81 to 82, so that the
20 additional factors are one to six making it 82 to 88.

21 Q Okay. And do you know what Reden & Anders has recommended
22 as an appropriate allocation for Washington?

23 A Yes, I do. It is in this report that was submitted this
24 morning.

25 Q And would that be between 72 to 76 percent?

1 A For Washington, yes.

2 Q For Washington?

3 A Yes.

4 Q With the corresponding percentage of 24 to 28 for Alaska?

5 A That's correct.

6 Q And, as I understand it from your previous testimony, is
7 that you made a number of adjustments to the data from 1945
8 to 2007; is that right?

9 A Yes, that's correct.

10 Q Okay. And one of the adjustments that you made was to the
11 expenses from 1997 to 2002; is that right?

12 A That's correct.

13 Q Okay. Am I correct that you made the adjustments to the '97
14 to 2002 data because you believed that data was inconsistent
15 with prior years?

16 A Inconsistent with prior years, inconsistent with future
17 years, inconsistent with the rate filings of the State of
18 Washington and inconsistent with the pricing analysis that
19 we did with the underwriting, management and actuarial team
20 at Premera.

21 Q Okay. And so you adjusted those numbers to comport with
22 your earlier adjustments to the data from prior years; is
23 that right?

24 A The - there are several different factors that were used
25 to estimate the appropriateness of the adjustments.

1 Q But just so I'm clear, one of the things that you did was to
2 adjust the actual data that you received from Premera from
3 1997 to 2002 to comport with adjustments that you had made
4 to previous historical data; is that right?

5 A And future and the other factors that I identified.

6 Q That's - thank you.

7 Do you know whether Premera's operating expense
8 allocations for the years 1997 to 2002 have been audited by
9 regulators such as the OIC?

10 A They might have. I believe they have been.

11 Q And do you know whether they passed those audits?

12 A I'm not sure. I haven't read a report.

13 Q Okay. And if you could turn to Page 16 of your final
14 report, which I think is marked S-24.

15 A Okay.

16 Q Down at the bottom of the page there is an indented lower
17 case "A."

18 A Yes.

19 Q The second sentence in there, "If a subsidiary company had
20 started in 1953 in another state, i.e. other than
21 Washington, that company would have experienced higher
22 expenses to start up operation;" is that correct?

23 A That's correct.

24 Q Okay. Does that mean that you assumed because it would
25 ordinarily take capital to start up a subsidiary company

1 that Premera would have required capital to start up its
2 Alaska operations?

3 A It is a different consideration that is factored in
4 elsewhere. This is just talking about the administrative
5 expenses that would be required.

6 Q I'm sorry. I didn't mean to say capital. I meant to say
7 expenses. It would have had these additional expenses?

8 A The assertion is that that would have been appropriate for
9 the expenses at that time, yes.

10 Q And that's if - and that's based upon the assumption that if
11 they were starting up a subsidiary company in another state,
12 they would have required these expenses; is that right?

13 A No, it is based on the fact that they need to get allocated
14 their full costs of doing operations.

15 Q Do you have any hard evidence of the costs that they
16 incurred for operating in Alaska early on during the time
17 frame that you have mentioned here?

18 A No, we do not. As I spoke of earlier, there was very little
19 expense documentation until the 1980s.

20 Q And the administrative services were already in place in
21 Washington; is that right?

22 A Those systems were in existence in Washington, yes.

23 Q Okay. And the Alaska operations weren't a subsidiary, is
24 that right, they were simply an extension of Premera's
25 business?

1 A They were a new division. I guess you could use different
2 terms, but --

3 Q But they weren't a subsidiary; is that right?

4 A They were not an independent subsidiary, no.

5 Q Okay. And if Premera had received contributions from
6 external sources to start up its Alaska operations, would
7 this account for a lack of allocation start-up expenses
8 being included in its books?

9 A Could you say that again, please?

10 Q Sure.

11 If Premera had received contributions from external
12 sources for its Alaska start-up operations, would this
13 account for a lack of allocation of those expenses being
14 reported on its books?

15 A I can't speak to that without reviewing documents, so I
16 don't know.

17 Q No, I'm sorry. I'm asking if this occurred, if they
18 received money from other sources to start up their business
19 in Alaska, isn't it possible that the - that that was a
20 reason why the expenses were not allocated on their books;
21 is that right?

22 A It is possible, but we --

23 Q Thank you.

24 A -- reviewed each of components --

25 Q Mr. Staehlin, I'm sorry, we are under real tough time

1 constraints, so I would appreciate it if you would just
2 answer my questions.

3 And in your report you conclude that Alaska was not of
4 sufficient size to support its capital needs in the early
5 years and that it required a loan from Washington; is that
6 right?

7 A That's correct.

8 Q And we have already established that it wasn't a stand-alone
9 entity; is that right?

10 A It was not a stand-alone entity.

11 Q So exactly what would its capital needs have been?

12 A Now there is a two-company allocation of value.

13 Q But not now, when it started up.

14 A If it would have had a separate set of financial statements,
15 it would have been easy to track that and say what the
16 effect was today, but unfortunately there were not.

17 Q Do I understand it correctly, you have allocated a certain
18 portion of Premera's value to Washington based on this
19 supposed need for capital in Alaska; is that right?

20 A That is in the additional considerations, yes.

21 Q But you don't know what the capital needs actually were; is
22 that right?

23 A It was based on --

24 Q No, I'm sorry, Mr. Staehlin. My question was you didn't
25 know what the capital needs were; is that correct?

1 A As not communicated by Premera as estimated by our work,
2 yes.

3 Q Okay. Thank you.

4 New business is generally considered less certain than
5 existing business; is that right?

6 A Less certain in what way?

7 Q Meaning whether Premera might acquire new business or
8 whether that new business might be profitable is more risky
9 than existing business; is that right?

10 A Are you asking me a general question or are you asking about
11 Premera specifically?

12 Q I'm asking you a general question.

13 A Generally, new business may have more risk because it
14 requires acquiring an unknown.

15 Q Thank you.

16 And I just want to ask you a few questions about your
17 additional considerations. These additional considerations
18 are qualitative factors, are they not?

19 A They are qualitative that were attempted to be quantified.

20 Q They were attempted to be quantified --

21 A Yes, they were.

22 Q -- is that right?

23 A Yes, they were.

24 Q And how did you attempt to quantify those?

25 A Do you want to pick an individual factor?

1 Q Yeah. I would like to pick the IPO participation fee and I
2 would like to you explain how you quantified that.

3 A It was quantified as one factor in my report that was a team
4 effort between Blackstone, myself and Don Nemerov, the
5 compensation consultant for the PricewaterhouseCoopers team.

6 Q Okay. And it is my understanding that you decided to
7 include these additional considerations after discussions
8 with many individuals, including the OIC staff, the
9 Washington Attorney General and Cantilo & Bennett among
10 others; is that right?

11 A The team had met over the entire time frame, but these are
12 consistent with the initial report filed in August.

13 Q Right. So is your answer to my question "yes"?

14 A My answer is the factors were there. The discussion how to
15 quantify them may have continued to be formed over time as
16 they were discussed.

17 Q Okay. And how did you decide to consider these additional
18 considerations?

19 A From the basis of our review and where there appeared to be
20 strengthening after we reviewed all the history and what was
21 there and what was not there.

22 Q Mr. Staehlin, do you remember that Mr. Kelly took your
23 deposition on March 5th of 2004?

24 A I know it was the first week of March, yes.

25 Q And do you remember that I also participated in that

1 deposition --

2 A Yes, I do.

3 Q -- and that I asked you a number of questions?

4 A Yes.

5 Q And do you remember that I asked you that identical question
6 that I just asked you?

7 A Possibly.

8 Q That is how did you decide to consider these additional
9 considerations?

10 A Possibly.

11 Q Okay. And your answer was, "This is the whole team talking
12 together." And it goes on to say - "I mean, the OIC, the
13 Attorney General, Cantilo & Bennett, Blackstone, PwC tax,
14 PwC accounting, PwC economics and PwC actuarial;" is that
15 correct?

16 A Yes.

17 Q Okay. In your actuarial engagements, do you generally allow
18 others to influence the factors that you consider?

19 A Do I generally - there is usually a team. I am the last
20 authority to talk about what is appropriate, especially in
21 the areas of actuarial judgment. And there are times when
22 I'm influenced by a lot of people giving me data that I have
23 to sift through and make a judgment.

24 Q Such as the OIC staff?

25 A It doesn't need to always be an actuary that gives me

1 information.

2 Q Okay. And of the ASOPs that you listed - and that is the
3 Actuarial Standard of Practice; is that right?

4 A That's correct.

5 Q The ones that you listed in Footnote 2 on Page 1 of the
6 "Executive Summary" of your report - and feel free to . . .

7 Can you tell me which one directed you to consider these
8 additional considerations when performing your contribution
9 analysis?

10 A Not off the top of my head right now. I would need to
11 review it and consider it.

12 Q Can you just quickly scan it and tell me?

13 A Quickly, I would have to say it was all in conjunction. I
14 really can't pick one out right now to say it is primary.

15 Q So are you saying all in conjunction, they all directed you
16 to consider these additional considerations?

17 A Because of the scope of the engagement, yes, it was the
18 whole process.

19 Q Okay. And the whole - so within the scope of the
20 engagement, all of these ASOPs that you have listed directed
21 you to consider these additional considerations?

22 A I guess the primary one would be credibility of data, if it
23 is in there somewhere, Number 25 - well, 23 and 25, data
24 quality and credibility that one would apply to data.

25 Q Thank you.

1 Would you agree that if in your analysis it is
2 appropriate to consider loans from Washington to Alaska such
3 as for capital needs, that it also would be appropriate to
4 consider loans that may have been made from Alaska to
5 Washington?

6 A If that's a hypothetical and could be presented as a
7 consistent methodology, it could be appropriate.

8 Q And it is my understanding, I believe, that - let me check
9 my notes - that Washington experienced negative cumulative
10 operating income in the late '90s; is that right?

11 A It may have both - as I stated, both companies have had
12 negative years in their history.

13 Q Okay. And I think Mr. Kelly put up on the - on the screen
14 yesterday a figure of 21 point, I think, nine million for
15 1999; is that right?

16 A He put up an exhibit that had a negative number on it, yes.
17 I don't recall what year it was.

18 Q Okay. So if the Alaska operations had been profitable
19 during that same time, using the approach that you have
20 taken, would it be fair to characterize this as Alaska
21 having the moved money to Washington to offset those losses?

22 A It might be your characterization. You have to look at the
23 entire process over time as opposed to picking one year.

24 Q Okay. Okay. So if I looked for a period of time such as
25 maybe 1983 to 1999 and Washington had been experiencing a

1 number of operating income losses to the point where they
2 may have been insolvent and Alaska was profitable during
3 that time, would that be a fair characterization, meaning
4 that Alaska could be deemed to have loaned Washington money
5 during that time?

6 A It might have, but you have to start with 1945 and go to
7 1982 because you factor in 1983 to 1989.

8 Q Okay. Thank you.

9 Oh, and I'm sorry, I just realized I had one question
10 regarding your discussions with nonactuaries on - for your
11 additional considerations. Is that standard actuarial
12 practice?

13 A Standard actuarial practice is to evaluate all the
14 information and then make a judgment.

15 Q Including information that you get from other sources; is
16 that right?

17 A Yes.

18 Q Thank you.

19 And the IPO participation fee that you believe the
20 Alaska operations should be charged, this accounts for zero
21 to two percent of the total value; is that correct?

22 A That's correct.

23 Q Now, only one IPO is contemplated and that is for the
24 Premera holding company; is that right?

25 A That's correct.

1 Q And Premera is doing an IPO for its entire business; is that
2 right?

3 A That's correct.

4 Q Did Premera, at any time, represent to you that it was
5 contemplating an independent IPO for its Alaska operations?

6 A No, it did not.

7 Q And you have not determined what Premera's total value is;
8 is that right?

9 A That's correct.

10 Q And during your deposition in March Tom Kelly asked you a
11 number of questions and I'm going to read a couple of them
12 to you. Okay?

13 Question: "Okay. Well, do you think the IPO is going
14 to happen on the day of the ruling?"

15 Answer: "I'm sorry. I don't know about" --

16 And Mr. Kelly interrupted you.

17 Question: "You don't speak to IPOs?"

18 Answer: "I don't speak to IPOs."

19 Is that correct? Does that sound familiar?

20 A It sounds familiar as to when it was to actually happen.

21 Q Okay. Okay. Oh, so by that you meant you don't to speak to
22 IPOs in terms of when they will happen?

23 A That's correct.

24 Q But you speak to IPOs in other regards?

25 A In consultation with the team members, yes.

1 Q Such as how much one might cost?

2 A As to how much might be an appropriate charge for a lesser
3 partner in a joined offering, yes.

4 Q But my question was for how much one might cost, not one -
5 whether, you know, one entity might have to pay some portion
6 of that?

7 A No, I don't know how much one would cost. That was
8 information from the other team members.

9 Q So if you don't know how much an IPO would cost, how were
10 you able to determine that the Alaska operations should pay
11 five million dollars for the IPO?

12 A The other consultants aided me in the calculations that I
13 reviewed.

14 Q Okay. And your preliminary report, which is marked as 23,
15 could you take a look at that --

16 A Mm-hmm.

17 Q -- on Page 4?

18 A Yes.

19 Q You have listed two factors here, which I believe these are
20 what you deemed these additional considerations; is that
21 right?

22 A In the preliminary report, that's the way it was listed,
23 yes.

24 Q Right. And the first one is the statement that, you know,
25 given the Alaska business was small in size and that

1 Washington was - and I know I'm paraphrasing here - and
2 Washington was the 90/10 parent for 50 years; is that right?

3 A Yes.

4 Q Well, Washington has never been the 90/10 parent; isn't that
5 correct?

6 A That's a characterization, yes.

7 Q And the second factor is regarding growth projections; is
8 that right?

9 A Yes. It is about the projections, yes.

10 Q Okay. But you haven't included in here an IPO participation
11 fee; is that right?

12 A I think it is in the entire estimate. It maybe wasn't
13 discussed in detail as we were working on the detailed
14 report.

15 Q But in this preliminary report you have only listed the two
16 additional considerations; is that right?

17 A That's correct.

18 Q And your final report lists the IPO participation fee?

19 A That's correct.

20 Q Yet your final allocation recommendation range did not
21 change from the preliminary report to the final report; is
22 that right?

23 A That's correct.

24 Q Thank you.

25 MS. McCULLOUGH: Thank you. No further questions.

1 MR. HAMJE: I do have some questions on redirect.

2
3 REDIRECT EXAMINATION

4
5 BY MR. HAMJE:

6 Q Mr. Staehlin, Mr. Kelly referred you to some deposition
7 testimony that took place back in March of this year
8 concerning a question that was raised by Ms. McCullough
9 about why you didn't use the cost of capital and then you
10 discussed - went on and answered talking about Premera not
11 having any free capital.

12 And then did you have any other comments with respect
13 to - with respect to this particular exchange so that you
14 could put it into context?

15 A Yes. The - the way Alaska - the Alaska consultants treated
16 the cost of capital is they, in my estimation, overvalued
17 the difference, this risk we talked about between new and
18 existing business.

19 And so in our review with Premera management, including
20 underwriting and actuarial, of over approximately a
21 year-and-a-half period, our judgment is although there may
22 be theoretical risk between new and existing, not in the way
23 Premera administers its business. They are virtually the
24 same risk. And so going through and doing differential
25 lapse rates and different values for new versus existing is

1 an incorrect application of the ASOP-19 in this regard.

2 Q Also you were asked in connection with the slide S-69 about
3 the number of limitations with respect to various of the
4 categories that were set out there.

5 I wanted to ask you, do those limitations significantly
6 reduce the thousand rate cells that you spoke of?

7 MR. KELLY: Objection. Leading.

8 JUDGE FINKLE: Sustained.

9 Q (BY MR. HAMJE) Do those limitations reduce the complexity
10 of the - of the calculation of rates?

11 MR. KELLY: Objection. Leading.

12 JUDGE FINKLE: Sustained. It is just - "whether or
13 not" will cure the problem.

14 MR. HAMJE: Thank you, Your Honor.

15 Q (BY MR. HAMJE) Do the - can you tell me whether or not the
16 limitations that Mr. Kelly spoke of with you reduce the
17 complexity of the calculations for the rates?

18 A I don't believe they do.

19 Q Also you were asked about - questions about the - about the
20 revenue neutrality with respect to the new plans that you
21 talked about concerning this being a rating alternative for
22 Premera. Do you recall that testimony?

23 A Yes.

24 Q Are you suggesting that if Premera - well, let me ask you
25 this: Is this particular rating alternative illegal?

1 MR. KELLY: I will object. Vague and leading.

2 MR. HAMJE: It is --

3 JUDGE FINKLE: I'm sorry. I just don't understand
4 it too well.

5 Q (BY MR. HAMJE) Can you tell me whether or not you believe
6 that rating alternative that you suggested is illegal?

7 A I don't believe it is.

8 Q Can you tell me whether or not it would be unethical for a
9 company to go ahead and - and follow that rate - rate
10 alternative that you suggested?

11 MR. KELLY: I will object. There is no - lack of
12 foundation. No rating alternative is suggested.

13 JUDGE FINKLE: Could you be more specific as to what
14 you are referring to?

15 MR. HAMJE: Surely. I thought I was.

16 Q (BY MR. HAMJE) I'm talking about the - what has been termed
17 as, I think, in previous testimony the Staehlin proposal.
18 Do you recall that?

19 MR. KELLY: I will object. There is no - this
20 witness did not discuss the old Staehlin proposal at all
21 today. Let me voir dire.

22

23

24

25

VOIR DIRE EXAMINATION

BY MR. KELLY:

Q You didn't discuss it today, did you?

A I did not.

MR. HAMJE: Let me ask it another way.

REDIRECT EXAMINATION

(Resumed)

BY MR. HAMJE:

Q Let me go back to the issue of where you were talking to Mr. Kelly about revenue neutrality and with respect to new plans. Do you recall that testimony?

A Yes.

Q You have suggested - if I recall correctly, you have suggested a method that Premera could go ahead and utilize to raise rates in a different - in Eastern Washington; is that correct?

MR. KELLY: I will object. No foundation. Wasn't covered.

MR. HAMJE: Well --

JUDGE FINKLE: Could - could you rephrase it? I don't - I'm not tracking with you. I'm sorry. You need to be more specific about his actual testimony or ask an open

1 question.

2 Q (BY MR. HAMJE) If I understand your testimony correctly,
3 you discussed - you indicated that even under the revenue
4 neutrality requirement, that by utilizing a new plan, that
5 it would not be necessary to comply with revenue neutrality;
6 is that correct?

7 MR. KELLY: Objection. Leading.

8 JUDGE FINKLE: Overruled. It is just preliminary, I
9 think.

10 A I don't think I testified you wouldn't need to comply with
11 revenue neutrality, but that revenue neutrality would
12 essentially be mitigated.

13 Q (BY MR. HAMJE) If a new plan were filed along those lines,
14 would - without - without having to utilize the existing
15 demographics or the current demographics, would that be
16 illegal?

17 MR. KELLY: I will object. Leading. Vague.

18 JUDGE FINKLE: Overruled.

19 A Could you ask the question again or read it back?
20

21 (Reporter read back question.)
22

23 A I don't think so.

24 Q (BY MR. HAMJE) You were also asked by Ms. McCullough in
25 your cross - in her cross of you concerning adjustments that

1 you made to expenses in connection with your allocation
2 report. Do you recall that testimony?

3 A Yes.

4 Q Why did you adjust the data?

5 A As I mentioned in my direct testimony, we analyzed each of
6 the components of trying to get the right end deposit for
7 Alaska - for allocation for Alaska versus Washington. And
8 in our judgment, the filed statements were not appropriately
9 reflective of true costs. So we felt adjustments were made
10 essentially for many of the years from 1945 to 2003.

11 Q Was it - were the adjustments appropriate?

12 A In my judgment, yes.

13 Q Why?

14 A It is basically outlined in the report, but that expenses
15 need to bear a reasonable relationship year over year to all
16 the components of the detail of the allocation, so they have
17 to be related year over year. They have to be related
18 according to product line. So we looked at expenses by the
19 subproduct lines. So we evaluated the data that was
20 provided by Premera that gave detail by product line. We
21 evaluated their rate filings and we evaluated the pricing
22 targets and their budgets.

23 All that information came into bear as to what would be
24 appropriate recognition of expenses for Washington versus
25 Alaska versus what was filed.

1 Q You were also asked about - a hypothetical about external
2 contributions being made to the Alaska operation. Do you
3 recall that testimony?

4 A Yes, I do.

5 Q Did you find any evidence of that?

6 A Well, we evaluated contributions to surplus independent of
7 the building blocks that I talked about. That actually was
8 an eighth factor. We looked at deposits over time that were
9 made into the contribution - the surplus account, including
10 MSC, when MSC came in, and appropriately allocated them to
11 the two states.

12 Q Why did you include the IPO participation fee as an
13 additional consideration?

14 A As I mentioned, in talking to people over time, we had an
15 initial report and then it was followed up by a final report
16 and although the building blocks stayed the same, some of
17 the qualitative factors became more focused through
18 discussions over time.

19 MR. HAMJE: That's all I have. Thank you.

20

21 RECROSS-EXAMINATION

22

23 BY MR. KELLY:

24 Q I just want to follow up on Ms. Hamburger's questions a
25 little bit. She was talking about the length of time for

1 these assurances. Now, these assurances have put Premera at
2 risk for detrimental effects, do they not?

3 A They might, but as I said, they have used essentially the
4 same rating formula through some other changes in the
5 market.

6 Q I understand, but let's take the example of brokers
7 commissions. If Premera is now committed not to change the
8 brokers commissions rates statewide, then its competitors
9 would be in a position to reduce - or to increase their
10 commissions to their brokers thereby attracting business
11 away from Premera while Premera's hands would be tied during
12 whatever period of time it has to put up with these - comply
13 with these assurances; isn't that correct?

14 A That might give an advantage, but if they charge the same
15 rate, they would be at a loss because they would be charging
16 a higher broker fee.

17 Q Well, they might want to induce customers to come over for a
18 variety of reasons, entering into the market or something
19 else; isn't that possible?

20 A That is possible.

21 Q Okay. And, in general - and so there is nothing in your
22 reports or your prefiled testimony that indicates that PwC
23 has done any study as to the potential negative impacts on
24 Premera's competitive position by extending the assurances
25 beyond two years; isn't that true?

1 A That's true.

2 Q And, in general, if rates go up, what - what is the
3 expectation, all things being equal, will happen to the
4 number of members that you have?

5 Let me rephrase the question. I will ask a leading
6 question. If rates go up, isn't it likely that membership
7 is going to go down to some extent?

8 A If you are the only one changing rates, if that's your
9 question.

10 Q Yes.

11 A Yes.

12 Q And doesn't that - wasn't that confirmed by Ms. Donigan's
13 testimony saying that membership losses occur when Premera
14 has effected a rate increase?

15 A She may have said that. She has also been here a short
16 period of time.

17 Q But, unfortunately, from what you said, she is right?

18 A Well, she may be right in isolated instances.

19 Q And you do understand that Dimensions is not a separate
20 company from Premera?

21 A Yes, I do understand that.

22 Q Very good.

23 MR. KELLY: Thank you, sir.

24 MS. HAMBURGER: I have no questions.

25 MS. McCULLOUGH: Just one.

RECROSS-EXAMINATION

BY MS. McCULLOUGH:

Q The IPO participation is an investment banking consideration, not an actuarial consideration; isn't that right?

A It is largely valued as an investment banking consideration and added through my actuarial judgment to be appropriate for this transaction.

MS. McCULLOUGH: Thank you. No further questions.

MR. HAMJE: No further questions.

EXAMINATION

BY COMMISSIONER KREIDLER:

Q Mr. Staehlin, let me just ask one question and it won't be on allocation, I can assure you.

Can you explain for the record the effect on the rating of economic assurances that require Premera to continue the - continue to use the same benefit relativity factors in Eastern and Western Washington?

A The effect on rates? Our judgment is the effect on rates will then just be consistent with Premera's assertions that they anticipate no change and anticipate holding to that practice.

1 COMMISSIONER KREIDLER: Thank you very much.

2 JUDGE FINKLE: Any follow-up?

3 MR. HAMJE: No follow-up.

4 MR. KELLY: Nothing. Thank you.

5 MS. McCULLOUGH: No.

6 JUDGE FINKLE: Thanks. Please step down.

7 MR. HAMJE: May this witness be excused?

8 JUDGE FINKLE: He may.

9 MR. HAMJE: Your Honor, we can start someone, if you
10 would like to do so tonight, or --

11 JUDGE FINKLE: I'm not eager, but --

12 MR. KELLY: I would - if it is Mr. Gold, I think we
13 can get him on and off pretty quickly.

14 MR. HAMJE: I would anticipate a least a half-hour
15 of --

16 MR. KELLY: I can assure you it will be --

17 MS. McCULLOUGH: I won't have anything.

18 JUDGE FINKLE: Well, let me ask you a broader
19 question. How are we doing overall?

20 MR. HAMJE: I think we are doing quite well. As I
21 see it, we have - let's see. We have got - we have just -
22 in addition to Mr. Odiorne, who will be at the end of - at
23 the close of evidence, we just have three more witnesses,
24 Dr. Gold, Lichiou Lee and Mr. Cantilo.

25 And now, I do understand that there would be two out of

1 order Intervenors' witnesses tomorrow. It could very
2 possibly be - depending on how long the out-of-order
3 witnesses take, it could be that we could start at least -
4 maybe even finish - Mr. Cantilo tomorrow.

5 MR. KELLY: There - you know, there is things to do
6 at the end of the hearing. I think 19 is what the
7 Intervenors have, so I would ask that we just go to 5:30.

8 JUDGE FINKLE: How many live witnesses are we
9 talking about from Alaska and from other Intervenors? I
10 know about a couple, but not - that have just been
11 referenced.

12 MS. HAMBURGER: Due to the shortness of time, we are
13 considering whether we are going to continue to have all of
14 the witnesses that we have listed. We have identified who
15 we anticipate will be appearing to testify through Friday.

16 MR. KELLY: The only problem I see with that is we
17 are going to have to strike and remove their prefiled
18 testimony, if I can't cross them.

19 MS. HAMBURGER: It is my understanding that the
20 prefiled testimony has been treated as if they were exhibits
21 and that somebody as to move to admit an exhibit and we
22 would expect that would be the process.

23 MR. KELLY: As long as it is understood.

24 MS. HAMBURGER: But I'm not conceding it wouldn't be
25 part of the record. It can be used by other --

MR. KELLY: I am just putting everyone on notice that I will object if the witness doesn't appear.

JUDGE FINKLE: Okay. Understood.

How about Alaska?

MS. McCULLOUGH: We originally - two of our original five will still be testifying.

(Side conference between
Judge Finkle and Commissioner.
Kreidler.)

JUDGE FINKLE: I'm sorry. We really need to adjourn for the day and we will be back in session tomorrow.

MR. HAMJE: Thank you, Your Honor.

(Proceedings adjourned.)

C E R T I F I C A T E

I, KRISTIN D. MANLEY, a court reporter in the State of Washington, do hereby certify that I was present during the foregoing matter and reported said proceedings stenographically.

I, DO FURTHER CERTIFY that the foregoing transcript constitutes a full, true, and accurate transcript of that portion of my stenograph notes so taken and so ordered.

I, DO FURTHER CERTIFY that I am not related to any of the parties to this lawsuit, nor am I interested in the outcome thereof.

Dated this 16th day of May, 2004.

KRISTIN D. MANLEY

CCR NO. 2211